ALTAPACIFIC BANCORP

CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2010 AND 2009

AND FOR THE YEARS THEN ENDED

AND

INDEPENDENT AUDITOR'S REPORT

PERRY-SMITH
THE POWER OF CONFIDENCE

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INDEPENDENT AUDITOR'S REPORT

The Shareholders and
Board of Directors
AltaPacific Bancorp

We have audited the accompanying consolidated balance sheet of AltaPacific Bancorp, (the "Company") as of December 31, 2010 and 2009 and the related consolidated statements of income, changes in shareholders' equity and comprehensive income and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of AltaPacific Bancorp as of December 31, 2010 and 2009 and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Perry-Smith LLP

March 14, 2011

ALTAPACIFIC BANCORP

CONSOLIDATED BALANCE SHEET

December 31, 2010 and 2009

	2010	2009
ASSETS		
Cash and due from banks	$ 790,000	$ 671,000
Federal funds sold	1,510,000	1,020,000
Total cash and cash equivalents	2,300,000	1,691,000
Interest-bearing deposits in banks	3,287,000	10,091,000
Available-for-sale investment securities (Note 2)	9,645,000	9,217,000
Loans, less allowance for loan losses of $1,423,000 in 2010 and $1,251,000 in 2009 (Notes 3, 4, 9 and 12)	60,132,000	60,268,000
Premises and equipment, net (Note 5)	625,000	789,000
Other real estate owned	781,000	
Accrued interest receivable and other assets	3,027,000	1,629,000
	$ 79,797,000	$ 83,685,000
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Non-interest bearing	$ 8,608,000	$ 7,724,000
Interest bearing (Note 6)	38,531,000	42,833,000
Total deposits	47,139,000	50,557,000
Short-term borrowings (Note 8)	5,000,000	7,500,000
Accrued interest payable and other liabilities	608,000	617,000
Total liabilities	52,747,000	58,674,000
Commitments and contingencies (Note 9)		
Shareholders' equity (Notes 10 and 11):		
Preferred stock – no par value; 10,000,000 shares authorized, none outstanding	-	-
Common stock – no par value; 40,000,000 shares authorized; 2,750,000 and 2,887,484 shares issued and outstanding in 2010 and 2009, respectively	30,508,000	28,826,000
Accumulated deficit	(3,264,000)	(2,685,000)
Accumulated other comprehensive loss	(194,000)	(1,130,000)
Total shareholders' equity	27,050,000	25,011,000
Total liabilities and shareholders' equity	$ 79,797,000	$ 83,685,000

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

ALTAPACIFIC BANCORP

CONSOLIDATED STATEMENT OF INCOME

For the Years Ended December 31, 2010 and 2009

	2010	2009
Interest income:		
Interest and fees on loans	$ 4,676,000	$ 3,773,000
Interest on available-for-sale investment securities	811,000	1,090,000
Interest on deposits in banks	112,000	86,000
Interest on Federal funds sold	10,000	9,000
Total interest income	5,609,000	4,958,000
Interest expense:		
Interest on deposits (Note 6)	503,000	499,000
Interest on short-term borrowings	6,000	1,000
Total interest expense	509,000	500,000
Net interest income	5,100,000	4,458,000
Provision for loan losses (Note 4)	785,000	866,000
Net interest income after provision for loan losses	4,315,000	3,592,000
Non-interest income:		
Service charges and fees	11,000	12,000
Non-interest expense:		
Salaries and employee benefits (Notes 3 and 13)	2,273,000	1,953,000
Occupancy and equipment (Notes 5 and 9)	482,000	478,000
Other (Note 14)	1,079,000	996,000
Total non-interest expense	3,834,000	3,427,000
Income before income taxes	492,000	177,000
Income tax benefit (Note 7)	(410,000)	(271,000)
Net income	902,000	448,000
Basic earnings per share	$ 0.30	$ 0.15
Diluted earnings per share	$ 0.29	$ 0.15
Weighted average number of shares outstanding – basic	3,031,858	3,031,858
Weighted average number of shares outstanding – diluted	3,076,164	3,031,968

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

ALTAPACIFIC BANCORP

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY AND COMPREHENSIVE INCOME

For the Years Ended December 31, 2010 and 2009

	Common Stock					
	Shares	Amount	Accumulated Deficit	Accumulated Other Compre-hensive Loss	Total Shareholders' Equity	Compre-hensive Income
Balance, January 1, 2009	2,750,000	$ 28,504,000	$ (3,133,000)	$ (1,182,000)	$ 24,189,000	
Share-based compensation (Note 10)		322,000			322,000	
Comprehensive income:						
Net income			448,000		448,000	$ 448,000
Unrealized gain on available-for-sale investment securities (Note 2)				52,000	52,000	52,000
						$ 500,000
Balance, December 31, 2009	2,750,000	28,826,000	(2,685,000)	(1,130,000)	25,011,000	
Stock dividend and fractional shares	137,484	1,481,000	(1,481,000)			
Share-based compensation (Note 10)		201,000			201,000	
Comprehensive income:						
Net income			902,000		902,000	902,000
Unrealized gain on available-for-sale investment securities, net of tax (Note 2)				936,000	936,000	936,000
						$ 1,838,000
Balance, December 31, 2010	2,887,484	$ 30,508,000	$ (3,264,000)	$ (194,000)	$ 27,050,000	

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

ALTAPACIFIC BANCORP

CONSOLIDATED STATEMENT OF CASH FLOWS

For the Years Ended December 31, 2010 and 2009

	2010	2009
Cash flows from operating activities:		
Net income	$ 902,000	$ 448,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	785,000	866,000
Depreciation and amortization, net	18,000	(113,000)
Loss on disposal of premises and equipment		14,000
Deferred loan origination costs and fees, net	21,000	76,000
Share-based compensation	201,000	322,000
Deferred tax benefit	(132,000)	(51,000)
Change in valuation allowance on deferred tax assets	(665,000)	(311,000)
Decrease (increase) in accrued interest receivable and other assets	330,000	(647,000)
(Decrease) increase in accrued interest payable and other liabilities	(9,000)	11,000
Net cash provided by operating activities	1,451,000	615,000
Cash flows from investing activities:		
Net decrease (increase) in interest bearing deposits in banks	6,804,000	(5,825,000)
Purchase of available-for-sale investment securities	(2,167,000)	
Purchase of Federal Reserve Bank stock	(775,000)	
Purchase of Federal Home Loan Bank stock	(21,000)	(217,000)
Proceeds from principal payments of mortgage-backed securities	2,736,000	2,783,000
Loans funded, net	(1,451,000)	(24,065,000)
Purchase of premises and equipment	(50,000)	(151,000)
Net cash provided by (used in) investing activities	5,076,000	(27,475,000)
Cash flows from financing activities:		
Increase in demand and money market deposits, net	7,829,000	6,767,000
(Decrease) increase in time deposits, net	(11,247,000)	16,775,000
(Decrease) increase in short-term borrowings	(2,500,000)	4,500,000
Net cash (used in) provided by financing activities	(5,918,000)	28,042,000
Increase in cash and cash equivalents	609,000	1,182,000
Cash and cash equivalents at beginning of period	1,691,000	509,000
Cash and cash equivalents at end of year	$ 2,300,000	$ 1,691,000
Supplemental disclosure of cash flow information:		
Cash paid during the year for interest expense	$ 516,000	$ 487,000
Cash paid during the year for income taxes	$ 168,000	$ 337,000
Non-cash investing activities:		
Other real estate owned acquired through foreclosure	$ 781,000	

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Company

AltaPacific Bancorp was incorporated as a bank holding company for the purpose of acquiring AltaPacific Bank (the "Bank") in a one bank holding company reorganization. The new corporate structure gives the Company and the Bank greater flexibility in terms of operation, expansion and diversification. The reorganization was approved by the Bank's shareholders on May 13, 2010, and all required regulatory approvals with respect to the reorganization were obtained. The reorganization was consummated in March 2010, subsequent to which the Bank continued its operations as previously conducted but as a wholly-owned subsidiary of AltaPacific Bancorp.

AltaPacific Bancorp's principal business is to serve as a holding company for the Bank and its principal source of income will be derived from dividends paid by the Bank. The payment of dividends by the Bank is subject to restrictions that could limit AltaPacific Bancorp's payment of dividends to its shareholders.

The Bank

AltaPacific Bank was organized under the laws of the State of California on February 16, 2006. The Bank opened for business as a state-chartered non-member Bank on July 10, 2006. On November 5, 2010, the Company became a member of the Federal Reserve System (FRB). On August 3, 2009, the Bank amended its articles of incorporation to change its legal name from Atlantic Pacific Bank to AltaPacific Bank.

The Bank is subject to regulation by the California Department of Financial Institutions (the "DFI") and the FRB and its deposits are insured by the Federal Deposit Insurance Corporation up to applicable legal limits. The Bank is headquartered in Santa Rosa, California and provides products and services to customers who are predominately small to middle-market business, professionals and not-for-profit organizations located in Sonoma County and surrounding counties.

The Bank is participating in the FDIC's Transaction Account Guarantee Program. Under this program, through December 31, 2012, all noninterest-bearing transaction accounts are fully guaranteed by the FDIC for the entire amount in the account and the Bank is assessed an annual fee of 10 basis points for all noninterest-bearing transaction account deposit amounts exceeding the existing deposit insurance limit of $250,000. Coverage under the Transaction Account Guarantee Program is in addition to and separate from the coverage available under the FDIC's general deposit insurance rules.

Principles of Consolidation

The accounting and reporting policies of AltaPacific Bancorp and its subsidiary AltaPacific Bank (collectively, the "the Company") conform with accounting principles generally accepted in the United States of America and prevailing practices within the banking industry. Significant inter-company balances and transactions have been eliminated through consolidation.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Reclassifications

Certain reclassifications have been made to the prior year's balances to conform to the classifications used in the current year.

Subsequent Events

Management has reviewed all events occurring from December 31, 2010 through March 14, 2011, the date the financial statements were available to be issued, and no events occurred during this period requiring accrual or disclosure in the consolidated financial statements.

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. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Cash and Cash Equivalents

For the purpose of the consolidated statement of cash flows, cash and cash equivalents consist of cash and due from banks and Federal funds sold. Generally, Federal funds are sold for one day periods.

Investment Securities

Investment securities are classified into the following categories:

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

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

Management determines the appropriate classification of its investments at the time of purchase and may only change the classification in certain limited circumstances. All transfers between categories are accounted for at fair value. At December 31, 2010 and 2009, all securities are classified as available-for-sale and there were no transfers between categories for the years ended December 31, 2010 and 2009.

Gains and losses on the sale of investment securities are computed using the specific identification method. Interest earned on investment securities is reported in interest income, net of applicable adjustments for accretion of discounts and amortization of premiums.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Investment Securities (Continued)

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

Loans

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

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Loan Losses

The allowance for loan losses is an estimate of credit losses inherent in the Company's loan portfolio that have been incurred as of the balance-sheet date. The allowance is established through a provision for loan losses which is charged to expense. Additions to the allowance are expected to maintain the adequacy of the total allowance after credit losses and loan growth. Credit exposures determined to be uncollectible are charged against the allowance. Cash received on previously charged off amounts is recorded as a recovery to the allowance. The overall allowance consists of two primary components, specific reserves related to impaired loans and general reserves for inherent losses related to loans that are not 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, including principal and interest, according to the contractual terms of the original agreement. Loans determined to be impaired are individually evaluated for impairment. When a loan is impaired, the Company measures impairment based on the present value of expected future cash flows discounted at the loan's effective interest rate, except that as a practical expedient, it may measure impairment based on a loan's observable market price, or the fair value of the collateral if the loan is collateral dependent. A loan is collateral dependent if the repayment of the loan is expected to be provided solely by the underlying collateral.

A restructuring of a debt constitutes a troubled debt restructuring (TDR) if the Company for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider. Restructured workout loans typically present an elevated level of credit risk as the borrowers are not able to perform according to the original contractual terms. Loans that are reported as TDRs are considered impaired and measured for impairment as described above.

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

The Company maintains a separate allowance for each portfolio segment (loan type). These portfolio segments include commercial, commercial real estate construction (including land and development loans), commercial real estate mortgage, installment and home equity lines of credit. The allowance for loan losses attributable to each portfolio segment, which includes both impaired loans and loans that are not impaired, is combined to determine the Company's overall allowance, which is included on the balance sheet.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Loan Losses (Continued)

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

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

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

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

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

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

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Loan Losses (Continued)

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

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

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

Individual loans and receivables in homogeneous loan portfolio segments are not evaluated for specific impairment. Rather, the sole component of the allowance for these loan types is determined by collectively measuring impairment reserve factors based on management's assessment of the following for each homogeneous loan portfolio segment: (1) inherent credit risk, (2) historical losses and (3) other qualitative factors. These reserve factors are described in further detail below for each homogeneous loan portfolio segment.

Installment – An installment loan portfolio is usually comprised of a large number of small loans scheduled to be amortized over a specific period. Most installment loans are made directly for consumer purchases, but business loans granted for the purchase of heavy equipment or industrial vehicles may also be included. Economic trends determined by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans. Weak economic trends indicate that the borrowers' capacity to repay their obligations may be deteriorating.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Loan Losses (Continued)

Home equity lines of credit – The degree of risk in the home equity lines of credit portfolio depends primarily on the loan amount in relation to collateral value, the interest rate and the borrower's ability to repay in an orderly fashion. These loans generally possess a lower inherent risk of loss than other real estate portfolio segments. Economic trends determined by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans. Weak economic trends indicate that the borrowers' capacity to repay their obligations may be deteriorating.

Although management believes the allowance to be adequate, ultimate losses may vary from its estimates. At least quarterly, the Board of Directors reviews the adequacy of the allowance, including consideration of the relative risks in the portfolio, current economic conditions and other factors. If the Board of Directors and management determine that changes are warranted based on those reviews, the allowance is adjusted. In addition, the Company's primary regulators, the FRB and California Department of Financial Institutions, as an integral part of their examination process, review the adequacy of the allowance. These regulatory agencies may require additions to the allowance based on their judgment about information available at the time of their examinations.

Allowance for Credit Losses on Off-Balance-Sheet Credit Exposures

The Company also maintains a separate allowance for off-balance-sheet commitments. Management estimates anticipated losses using historical data and utilization assumptions. The allowance for off-balance-sheet commitments is included in accrued interest payable and other liabilities on the balance sheet.

Premises and Equipment

Premises and equipment are carried at cost. Depreciation is determined using the straight-line method over the estimated useful lives of the related assets. The useful lives of furniture, fixtures and equipment are estimated to be 3 to 10 years. Leasehold improvements are amortized over the lesser of the respective lease term (including renewal periods that are reasonably assured) or their useful lives, which are generally 3 to 10 years. Leased equipment meeting certain capital lease criteria is capitalized and the present value of the related lease payments is recorded as a liability. Amortization of capital leases is computed using a straight-line method over the shorter of the estimated and useful life of the equipment or the initial lease term.

Certain operating leases contain scheduled and specified rent increases or incentives in the form of tenant improvement allowances or credits. The scheduled rent increases are recognized on a straight-line basis over the lease term as an increase in the amount of rental expense recognized each period. Lease incentives, including tenant improvement credits, are capitalized at the inception of the lease and amortized on a straight-line basis over the lease term as a reduction of rental expense. Amounts accrued in excess of amounts paid related to the scheduled rent increases and the unamortized deferred tenant improvement credits are included in accrued interest payable and other liabilities on the balance sheet.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Premises and Equipment (Continued)

When assets are sold or otherwise disposed of, the cost and related accumulated depreciation or amortization are removed from the accounts, and any resulting gain or loss is recognized in income for the period. The cost of maintenance and repairs is charged to expense as incurred. The Company evaluates premises and equipment for financial impairment as events or changes in circumstances indicate that the carrying amount of such assets may not be fully recoverable.

Federal Home Loan Bank and Federal Reserve Bank Stock

The Company, as a member of the Federal Home Loan Bank of San Francisco (FHLB) and the FRB, is required to hold shares of capital stock in the FHLB and FRB in an amount specified by regulation and is adjusted periodically based on a determination made by the FHLB and FRB. At December 31, 2010 and 2009, the Company owned $379,000 and $358,000, respectively, of FHLB stock. At December 31, 2010, the Company owned $775,000 of FRB stock. The Company was not a member of FRB and therefore did not own FRB stock as of December 31, 2009.

These investments are recorded at cost, carried as restricted securities, and are periodically evaluated for impairment. Cash and stock dividends are both reported as income. These stocks are included in accrued interest receivable and other assets on the balance sheet.

Income Taxes

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates which are expected to be applied to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is recognized if, based on the weight of available evidence, management believes it is more likely than not that some portion or all of the deferred tax assets will not be realized.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Income Taxes (Continued)

The Company considers all tax positions recognized in its financial statements for the likelihood of realization. When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than fifty percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above, if any, is reflected as a liability for unrecognized tax benefits in the accompanying balance sheet along with any associated interest and penalties that would be payable to the taxing authorities upon examination. Interest expense and penalties associated with unrecognized tax benefits, if any, are classified as income tax expense in the statement of operations. The Company does not have a liability for unrecognized tax benefits, or uncertain tax positions, and has not accrued for any interest or penalties as of December 31, 2010.

Earnings Per Share

Basic earnings per share (EPS), which excludes dilution, is computed by dividing net income by the weighted-average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock, such as stock options, result in the issuance of common stock which shares in the earnings of the Company. The treasury stock method is applied to determine the dilutive effect of stock options in computing diluted earnings per share.

On February 3, 2010, the Board of Directors declared a five percent stock dividend payable on February 26, 2010 to shareholders of record on February 12, 2010. On October 1, 2010, the Board of Directors declared a five percent stock dividend payable on February 18, 2011 to shareholders of record on February 4, 2011. All share and per share amounts other than shares outstanding on the balance sheet and statement of changes in shareholders' equity and comprehensive income have been restated to give retroactive effect to these five percent stock dividends.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Share-Based Compensation

The Company has one share-based compensation plan, the Atlantic Pacific Company 2006 Equity Incentive Plan (the "Plan"), which has been approved by its shareholders and permits the grant of stock options and restricted stock for up to 909,562 shares of the Company's common stock of which 392,216 were available for future grants at December 31, 2010. The Plan is designed to attract and retain employees and directors. The amount, frequency, and terms of share-based awards may vary based on competitive practices, the Company's operating results and government regulations. New shares are issued upon option exercise or restricted share grants. The Plan does not provide for the settlement of awards in cash. The Plan requires that the option price may not be less than the fair market value of the stock at the date the option is granted, and that the stock must be paid in full at the time the option is exercised. All options expire on a date determined by the Board of Directors but not later than ten years from the date of grant. The vesting period is determined by the Board of Directors and is generally over a three to five year period.

Restricted stock awards are grants of shares of common stock that are subject to forfeiture until specific conditions or goals are met. Conditions may be based on continuing employment or achieving specified performance goals. During the period of restriction, participants holding restricted stock may have full voting and dividend rights. The restrictions lapse in accordance with a schedule or with other conditions determined by the board of directors. There have been no restricted stock awards granted since inception of the Company or its subsidiary.

The Company accounts for share-based compensation using a fair-value based method and requires that share-based compensation expense be recorded for all stock options that are ultimately expected to vest as the requisite service is rendered.

Management estimates the fair value of each option award as of the date of grant using a Black-Scholes-Merton option pricing formula and the following assumptions. Expected volatility is based on historical volatility of similar entities over a preceding period commensurate with the expected term of the option because the Company's common stock has been publicly traded for a shorter period than the expected term for the options. The "simplified" method described in the Securities and Exchange Commission's Staff Accounting Bulletin No. 110 is used to determine the expected term of the options due to the lack of sufficient historical data. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant with substantially the same term as the expected term of the option. Expected dividend yield was not considered in the option pricing formula since cash dividends have not been paid and there are no current plans to do so in the foreseeable future. In addition to these assumptions, management makes estimates regarding pre-vesting forfeitures that will impact total compensation expense recognized under the Plan.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Comprehensive Income

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

Adoption of New Financial Accounting Standards

Transfers of Financial Assets

In June 2009, the Financial Accounting Standards Board ("FASB") issued FASB Accounting Standards Update ("ASU") 2009-16*, Accounting for Transfers of Financial Assets (Statement 166)*, which amends previously issued accounting guidance to enhance accounting and reporting for transfers of financial assets, including securitizations or continuing exposure to the risks related to transferred financial assets. Prior to the issuance of Statement 166, transfers under participation agreements and other partial loan sales fell under the general guidance for transfers of financial assets. Statement 166 introduces a new definition for a participating interest along with the requirement for partial loan sales to meet the definition of a participating interest for sale treatment to occur. If a participation or other partial loan sale does not meet the definition, the portion sold should remain on the books and the proceeds recorded as a secured borrowing until the definition is met. Additionally, existing provisions that require the transferred assets to be isolated from the originating institution (transferor), that the transferor does not maintain effective control through certain agreements to repurchase or redeem the transferred assets and that the purchasing institution (transferee) has the right to pledge or exchange the assets acquired were retained. The new provisions became effective for the Company on January 1, 2010 and early adoption was not permitted. The impact of adoption was not material to the financial statements.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Adoption of New Financial Accounting Standards (Continued)

Fair Value Measurements

In January 2010, the FASB issued FASB ASU 2010-06*, Improving Disclosures about Fair Value Measurements,* which amends and clarifies existing standards to require additional disclosures regarding fair value measurements. Specifically, the standard requires disclosure of the amounts of significant transfers between Level 1 and Level 2 of the fair value hierarchy and the reasons for these transfers, the reasons for any transfers in or out of Level 3, and information in the reconciliation of recurring Level 3 measurements about purchases, sales, issuances and settlements on a gross basis. This standard clarifies that reporting entities are required to provide fair value measurement disclosures for each class of assets and liabilities—previously separate fair value disclosures were required for each major category of assets and liabilities. This standard also clarifies the requirement to disclose information about both the valuation techniques and inputs used in estimating Level 2 and Level 3 fair value measurements. Except for the requirement to disclose information about purchases, sales, issuances, and settlements in the reconciliation of recurring Level 3 measurements on a gross basis, these disclosures are effective for the year ended December 31, 2010. The requirement to separately disclose purchases, sales, issuances, and settlements of recurring Level 3 measurements becomes effective for the Company for the year beginning on January 1, 2011. The Company adopted this new accounting standard as of January 1, 2010 and the impact of adoption was not material to the financial statements.

Disclosures about Credit Quality

In July 2010, the FASB issued FASB ASU 2010-20, *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*. ASU 2010-20 requires more robust and disaggregated disclosures about the credit quality of financing receivables (loans) and allowances for loan losses, including disclosure about credit quality indicators, past due information and modifications of finance receivables. The disclosures as of the end of a reporting period are effective for interim and annual reporting periods ending on and after December 15, 2010. The disclosures about activity that occurs during a reporting period are effective for interim and annual reporting periods beginning on or after December 15, 2010. The adoption of this guidance has significantly expanded disclosure requirements related to accounting policies and disclosures related to the allowance for loan losses but did not have an impact on the Company's financial position, results of operation or cash flows.

2. AVAILABLE-FOR-SALE INVESTMENT SECURITIES

The amortized cost and estimated fair value of available-for-sale investment securities at December 31, 2010 and 2009 consisted of the following:

	2010			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Mortgage-backed securities:				
Agency	$ 2,939,000	$ 43,000	$ (3,000)	$ 2,979,000
Non-agency	7,035,000	273,000	(642,000)	6,666,000
	$ 9,974,000	$ 316,000	$ (645,000)	$ 9,645,000

	2009			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Mortgage-backed securities:				
Agency	$ 1,718,000	$ 64,000		$ 1,782,000
Non-agency	8,629,000		$ (1,194,000)	7,435,000
	$ 10,347,000	$ 64,000	$ (1,194,000)	$ 9,217,000

Net unrealized gains on available-for-sale investment securities totaling $801,000 were recorded net of $135,000 in tax benefits, as other comprehensive income within shareholders' equity for the year ended December 31, 2010. Net unrealized gains on available-for-sale investment securities totaling $52,000 were recorded as other comprehensive income within shareholders' equity for the year ended December 31, 2009. There were no sales, calls or transfers of available-for-sale investment securities for the year ended December 31, 2010 or 2009.

Investment securities with unrealized losses at December 31, 2010 and 2009 are summarized and classified according to the duration of the loss period as follows:

	2010					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Mortgage-backed securities:						
Agency	$ 909,000	$ (3,000)			$ 909,000	$ (3,000)
Non-agency			$ 3,891,000	$ (642,000)	3,891,000	(642,000)
	$ 909,000	$ (3,000)	$ 3,891,000	$ (642,000)	$ 4,800,000	$ (645,000)

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

	2009					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Mortgage-backed securities:						
Non-agency	$ 957,000	$ (117,000)	$ 6,478,000	$ (1,077,000)	$ 7,435,000	$ (1,194,000)

The Company held four agency mortgage-backed securities of which one was in an unrealized loss position as of December 31, 2010 and seven non-agency mortgage-backed securities of which six were in an unrealized loss position as of December 31, 2010. The one agency mortgage-backed security had been in an unrealized loss position for less than twelve months and the six non-agency mortgage-backed securities had been in an unrealized loss position for more than 12 months. These unrealized losses were primarily caused by illiquidity in the marketplace and downgrades made by the rating agencies of the issuers. Management performed an impairment analysis using detailed cash flow analysis to determine the recoverability of all principal and interest contractually due. This analysis projects prepayments, expected housing price changes, delinquency and default rates, expected loss severities, and interest rates, while factoring in the underlying collateral. Based on this analysis, and because management does not have the intent to sell these securities nor does management believe it is more likely than not that the Company will be required to sell these securities before a recovery of amortized cost, the Company does not consider these investments to be other-than-temporarily impaired at December 31, 2010 and 2009.

The amortized cost and estimated fair value of available-for-sale investment securities at December 31, 2010 by contractual maturity are shown below.

	Amortized Cost	Estimated Fair Value
Mortgage-backed securities		
Agency		
One through five years	$ 756,000	$ 780,000
After ten years	2,183,000	2,199,000
	2,939,000	2,979,000
Non-agency		
After ten years	7,035,000	6,666,000
	$ 9,974,000	$ 9,645,000

Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without prepayment penalties.

Investment securities with amortized cost totaling $3,860,000 and estimated fair values totaling $3,940,000 were pledged to secure borrowings with the Federal Home Loan Company at December 31, 2010. Investment securities with amortized cost totaling $2,766,000 and estimated fair values totaling $2,735,000 were pledged to secure borrowings with the Federal Home Loan Company at December 31, 2009 (see Note 8).

3. LOANS

Outstanding loans are summarized below:

	December 31, 2010	December 31, 2009
Commercial	$ 7,591,000	$ 9,638,000
Real estate – construction	24,293,000	29,720,000
Real estate – mortgage	23,504,000	17,749,000
Consumer and other	6,450,000	4,674,000
	61,838,000	61,781,000
Deferred loan origination fees, net	(283,000)	(262,000)
Allowance for loan losses	(1,423,000)	(1,251,000)
	$ 60,132,000	$ 60,268,000

Salaries and employee benefits totaling $70,000 and $69,000 were deferred as loan origination costs for the years ended December 31, 2010 and 2009, respectively.

Certain loans are pledged as collateral for available borrowings with the FHLB. Pledged loans totaled $31,458,000 at December 31, 2010 (see Note 8).

At December 31, 2010 there were no loans on nonaccrual status or loans past due 90 days or more and still accruing interest. Interest foregone on nonaccrual loans totaled $69,000 for the year ended December 31, 2010. At December 31, 2009, nonaccrual loans totaled $1,394,000 and there were no loans past due 90 days or more and still accruing interest. Interest foregone on nonaccrual loans totaled $17,000 for the year ended December 31, 2009.

4. ALLOWANCE FOR LOAN LOSSES

Changes in the allowance for loan losses were as follows:

	Year Ended December 31, 2010	Year Ended December 31, 2009
Balance, beginning of year	$ 1,251,000	$ 739,000
Provision charged to operations	785,000	866,000
Losses charged to the allowance	(613,000)	(354,000)
Balance, end of year	$ 1,423,000	$ 1,251,000

4. ALLOWANCE FOR LOAN LOSSES (Continued)

The following table shows the allocation of the allowance for loan losses at and for the year ended December 31, 2010 by portfolio segment and by impairment methodology:

	Commercial	Commercial Real Estate – Construction	Commercial Real Estate – Mortgage	Installment	Home Equity Lines of Credit	Total
Allowance for Loan Losses						
Ending balance allocated to portfolio segments	$ 156,000	$ 816,000	$ 344,000	$ 54,000	$ 53,000	$ 1,423,000
Ending balance: individually evaluated for impairment	$ -	$ -	$ -	$ -	$ -	$ -
Ending balance: collectively evaluated for impairment	$ 156,000	$ 816,000	$ 344,000	$ 54,000	$ 53,000	$ 1,423,000
Loans						
Ending balance	$ 7,591,000	$24,293,000	$23,504,000	$ 5,019,000	$ 1,431,000	$61,838,000
Ending balance: individually evaluated for impairment	$ -	$ -	$ -	$ -	$ -	$ -
Ending balance: collectively evaluated for impairment	$ 7,591,000	$24,293,000	$23,504,000	$ 5,019,000	$ 1,431,000	$61,838,000

The following table shows the loan portfolio allocated by management's internal risk ratings at December 31, 2010:

	Commercial Credit Exposure Credit Risk Profile by Internally Assigned Grade			
	Commercial	Real Estate – Construction	Real Estate – Mortgage	Total
Grade:				
Pass	$ 6,319,000	$ 24,293,000	$ 23,504,000	$ 54,116,000
Special Mention	467,000			467,000
Substandard	805,000			805,000
Total	$ 7,591,000	$ 24,293,000	$ 23,504,000	$ 55,388,000

	Consumer Credit Exposure Credit Risk Profile Based on Payment Activity		
	Installment	Home Equity Lines of Credit	Total
Grade:			
Performing	$ 5,019,000	$ 1,431,000	$ 6,450,000
Non-performing			
Total	$ 5,019,000	$ 1,431,000	$ 6,450,000

4. ALLOWANCE FOR LOAN LOSSES (Continued)

The following table shows an aging analysis of the loan portfolio by the time past due at December 31, 2010:

	30-89 Days Past Due	90 Days and Still Accruing	Nonaccrual	Total Past Due	Current	Total
Commercial:						
Commercial					$ 7,591,000	$ 7,591,000
Real estate – construction					24,293,000	24,293,000
Real estate – mortgage					23,504,000	23,504,000
Consumer:						
Installment					5,019,000	5,019,000
Home equity lines of credit					1,431,000	1,431,000
Total	$ -	$ -	$ -	$ -	$61,838,000	$61,838,000

The Company did not have any impaired loans at December 31, 2010. At December 31, 2009, there was one impaired loan with a recorded investment of $1,394,000 and a specific allowance for loan losses of $209,000. The average outstanding balance of impaired loans for the years ended December 31, 2010 and 2009 was $680,000 and $750,000, respectively, on which no interest income was recognized on a cash basis. The Company does not have any loans or commitments to lend funds to borrowers with loans whose terms have been modified in troubled debt restructurings.

5. PREMISES AND EQUIPMENT

Premises and equipment consisted of the following:

	December 31, 2010	December 31, 2009
Furniture, fixtures and equipment	$ 962,000	$ 940,000
Leasehold improvements	763,000	763,000
	1,725,000	1,703,000
Less accumulated depreciation and amortization	(1,100,000)	(914,000)
	$ 625,000	$ 789,000

Depreciation and amortization included in occupancy and equipment expense totaled $214,000 and $245,000 for the years ended December 31, 2010 and 2009, respectively.

6. INTEREST-BEARING DEPOSITS

Interest-bearing deposits consisted of the following:

	December 31, 2010	December 31, 2009
Savings	$ 97,000	$ 66,000
Money market	29,357,000	22,427,000
Interest-bearing demand accounts	610,000	626,000
Time, $100,000 or more	7,196,000	16,399,000
Other time	1,271,000	3,315,000
	$ 38,531,000	$ 42,833,000

At December 31, 2009 all time deposits are scheduled to mature within twelve months.

Interest expense recognized on interest-bearing deposits for the years ended December 31, 2010 and 2009 consisted of the following:

	2010	2009
Savings and money market	$ 315,000	$ 277,000
Interest-bearing demand accounts	1,000	1,000
Time, $100,000 or more	158,000	183,000
Other time	29,000	38,000
	$ 503,000	$ 499,000

7. INCOME TAXES

Income taxes for the years ended December 31, 2010 and 2009 consisted of the following:

	Federal	State	Total
2010			
Current	$ 272,000	$ 115,000	$ 387,000
Deferred	(84,000)	(48,000)	(132,000)
Change in valuation allowance	(461,000)	(204,000)	(665,000)
Income tax benefit	$ (273,000)	$ (137,000)	$ (410,000)

7. INCOME TAXES (Continued)

	Federal	State	Total
2009			
Current	$ 19,000	$ 72,000	$ 91,000
Deferred	7,000	(58,000)	(51,000)
Change in valuation allowance	(226,000)	(85,000)	(311,000)
Income tax benefit	$ (200,000)	$ (71,000)	$ (271,000)

Deferred tax assets (liabilities) at December 31, 2010 and 2009 consisted of the following:

	2010	2009
Deferred tax assets:		
Allowance for loan losses	$ 600,000	$ 523,000
Organization costs	323,000	354,000
Share-based compensation	304,000	267,000
Unrealized loss on available-for-sale investment securities	135,000	465,000
Net operating losses	46,000	31,000
Other	65,000	21,000
Deferred tax assets before valuation allowance	1,473,000	1,661,000
Valuation allowance		(1,130,000)
Total deferred tax assets	1,473,000	531,000
Deferred tax liabilities:		
Future liability of state deferred tax asset	157,000	107,000
Other	22,000	62,000
Total deferred tax liabilities	179,000	169,000
Net deferred tax assets	$ 1,294,000	$ 362,000

7. INCOME TAXES (Continued)

The determination of the amount of deferred income tax assets which are more likely than not to be realized is primarily dependent on projections of future earnings, which are subject to uncertainty and estimates that may change given economic conditions and other factors. The realization of deferred income tax assets is assessed and a valuation allowance is recorded if it is "more likely than not" that all or a portion of the deferred tax asset will not be realized. "More likely than not" is defined as greater than a 50% chance. All available evidence, both positive and negative is considered to determine whether, based on the weight of that evidence, a valuation allowance is needed. Based upon its analysis of available evidence, management has determined that it is "more likely than not" that the Company's deferred income tax assets as of December 31, 2010 will be fully realized and therefore no valuation allowance was recorded.

At December 31, 2010, the Company had no Federal net operating loss carryforwards and State net operating loss carryforwards (NOLs) of $422,000. The State NOLs begin to expire in 2017.

The Bank files income tax returns in the United States and California jurisdictions. There are currently no pending Federal, state or local income tax examinations by tax authorities. Federal and California tax returns for 2007 to 2009 and 2006 to 2009, respectively, are currently open for examination. The total amount of unrecognized tax benefits, including interest and penalties, at December 31, 2010 was not material. The amount of tax benefits that would impact the effective rate, if recognized, is not expected to be material. The Bank does not anticipate any significant changes with respect to unrecognized tax benefits within the next 12 months.

8. SHORT-TERM BORROWING ARRANGEMENTS

The Company has unsecured Federal funds lines of credit with two of its correspondent banks under which it can borrow up to $4,000,000. There were no borrowings outstanding under these arrangements at December 31, 2010 and 2009.

The Company has a borrowing arrangement with the Federal Home Loan Company of San Francisco under which it may borrow an amount not to exceed 20% of total assets. Various loans totaling approximately $31,458,000 were pledged to secure FHLB borrowings as of December 31, 2010. In addition, investment securities with amortized costs of $3,860,000 and estimated fair values of $3,940,000 were pledged to secure the borrowing arrangement as of December 31, 2010. The total borrowing capacity under these arrangements was $15,961,000 at December 31, 2010. Investment securities with amortized costs of $2,766,000 and estimated fair values of $2,735,000 were pledged to secure the borrowing arrangement as of December 31, 2009. Total borrowing capacity under these arrangements was $12,789,000 at December 31, 2009.

9. COMMITMENTS AND CONTINGENCIES

Advances under these arrangements consisted of the following at December 31, 2010 and 2009:

2010		
Amount	Rate	Maturity Date
$ 5,000,000	0.26%	January 18, 2011

2009		
Amount	Rate	Maturity Date
$ 7,500,000	0.06%	January 4, 2010

Operating Lease

The Company leases its headquarters branch under a non-cancelable operating lease. The initial lease expires in June 2016 and has two five-year renewal options. The lease includes an annual rent adjustment of 3.5% each year during the initial lease term then adjusts to 95% of the fair market value of rents during the renewal periods.

Future minimum lease payments are as follows:

Year Ending December 31,	Operating Leases
2011	$ 261,000
2012	270,000
2013	279,000
2014	289,000
2015	299,000
Thereafter	154,000
	$ 1,552,000

Rental expense included in occupancy and equipment expense totaled $250,000 and $219,000 for the years ended December 31, 2010 and 2009 respectively.

Financial Instruments With Off-Balance-Sheet Risk

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business in order to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments consist of commitments to extend credit totaling $19,093,000 and $27,522,000 at December 31, 2010 and 2009, respectively.

9. COMMITMENTS AND CONTINGENCIES (Continued)

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

The Company's exposure to credit loss in the event of nonperformance by the other party for commitments to extend 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 included on the balance sheet.

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. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies, but may include accounts receivable, inventory, and deeds of trust on residential real estate and income-producing commercial properties.

At December 31, 2010 commercial loan commitments represent approximately 46% of total commitments and are generally unsecured or secured by collateral other than real estate and have variable interest rates. Real estate loan commitments represent approximately 37% of total commitments and are generally secured by property with a loan-to-value ratio not to exceed 80%. The majority of real estate commitments also have variable interest rates. Home equity lines of credit represent 17% of total commitments and are generally secured by residential real estate and have both variable and fixed interest rates.

Concentrations of Credit Risk

The Company grants real estate mortgage, real estate construction and commercial loans to customers throughout Sonoma, Marin and San Francisco counties. Although management intends to continue to diversify the Company's loan portfolio, a substantial portion of the portfolio is secured by commercial and residential real estate at December 31, 2010 and 2009.

In management's judgment, a concentration of loans exists in real estate related loans with approximately 80% of the Company's loans being real estate related. Although management believes the loans within this concentration have no more than the normal risk of collectibility, a substantial decline in the performance of the economy in general or a decline in real estate values in the Company's primary market area, in particular, could have an adverse impact on the collectibility of these loans. Personal and business income represent the primary source of repayment for a majority of these loans.

9. COMMITMENTS AND CONTINGENCIES (Continued)

Correspondent Companying Agreements (Continued)

The Company maintains funds on deposit with other federally insured financial institutions under correspondent banking agreements. Those insured financial institutions have elected to participate in the FDIC sponsored Transaction Account Guarantee Program. Under that program, through December 31, 2012, all noninterest-bearing transaction accounts are fully guaranteed by the FDIC for the entire amount in the account. Coverage under the Transaction Account Guarantee Program is in addition to and separate from the coverage available under the FDIC's general deposit insurance rules. This program was not in effect in 2009; however, there were no uninsured deposits at December 31, 2009.

10. SHARE-BASED COMPENSATION

Stock Option Awards

A summary of option activity under the Plan for the years ended December 31, 2010 and 2009 is presented below:

	Number of Stock Options	Weighted Average Exercise Prices	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value
Outstanding at January 1, 2009	490,338	$ 9.06	7.7 years	
Granted	30,319	$ 8.06		
Forfeited	(3,308)	$ 8.14		
Outstanding at December 31, 2009	517,349	$ 9.00	6.8 years	
Outstanding at December 31, 2010	517,349	$ 9.00	5.8 years	
Exercisable at December 31, 2010	498,053	$ 9.04	5.8 years	$ 339,000
Options expected to vest	19,057	$ 8.28	8.5 years	$ 30,000

As of December 31, 2010, the unrecognized share-based compensation expense related to non-vested stock option awards totaled $69,000. That cost is expected to be amortized on a straight-line basis over a weighted average period of 2.4 years and will be adjusted for subsequent changes in estimated forfeitures. Total compensation cost included in operating expenses was $201,000 and $322,000 for the years ended December 31, 2010 and 2009, respectively. The fair value of options vested during the year was $342,000 and $326,000 for the years ended December 31, 2010 and 2009, respectively.

10. SHARE-BASED COMPENSATION (Continued)

Stock Option Awards (Continued)

No stock options were granted during 2010. The following stock option information is for the year ended December 31, 2009:

	2009
Weighted average grant date fair value per share of options	$4.67
Significant weighted average assumptions:	
Expected term in years	6.5 years
Expected annual volatility	51.7%
Expected annual dividend yield	0.0%
Risk-free interest rate	2.2%

11. SHAREHOLDERS' EQUITY

Cash Dividends

Upon declaration by the Board of Directors, all shareholders of record will be entitled to receive dividends. The California Financial Code restricts the total cash dividend payment of any state banking association in any calendar year to the lesser of (1) the bank's retained earnings or (2) the bank's net income for its last three fiscal years, less distributions made to shareholders during the same three-year period. At December 31, 2010, no amounts were free of such restrictions.

Regulatory Capital

The Company and Bank are subject to certain regulatory capital requirements administered by the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation (FDIC). Failure to meet these minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Company’s consolidated financial statements. As a small bank holding company, the Company is not subject to specific regulatory capital requirements. The risk-based guidelines described below apply on a consolidated basis to bank holding companies with consolidated assets of $150 million or more. For bank holding companies with less than $150 million in consolidated assets, the guidelines will be applied on a bank-only basis unless: (a) The parent bank holding company is engaged in nonbank activity involving significant leverage; or (b) the parent company has a significant amount of outstanding debt that is held by the general public. Because the Company is neither, regulators look to the Bank's capital ratios when assessing the adequacy of the Company’s capital.

11. SHAREHOLDERS' EQUITY (Continued)

Regulatory Capital (Continued)

Under capital adequacy guidelines, 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. These quantitative measures are established by regulation and require that minimum amounts and ratios of total and Tier 1 capital to risk-weighted assets and of Tier 1 capital to average assets be maintained as set forth in the table on the following page. The Company's and Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors. Management believes the Bank met all of their capital adequacy requirements as of December 31, 2010 and 2009.

The Bank is also subject to additional capital guidelines under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the table on the following page. The most recent notification from the FDIC categorized the Bank as well capitalized under these guidelines. There are no conditions or events since that notification that management believes have changed the Bank's category.

The Bank's actual capital amounts and notations of December 31, 2010 and 2009 are as follows:

	2010		2009	
	Amount	Ratio	Amount	Ratio
Leverage Ratio				
AltaPacific Bank	$ 26,643,000	34.0%	$ 26,141,000	31.7%
Minimum requirement for "Well-Capitalized" institution under prompt corrective action provisions	$ 3,918,000	5.0%	$ 4,119,000	5.0%
Minimum regulatory requirement	$ 3,135,000	4.0%	$ 3,295,000	4.0%
Tier 1 Risk-Based Capital Ratio				
AltaPacific Bank	$ 26,643,000	37.4%	$ 26,141,000	35.2%
Minimum requirement for "Well-Capitalized" institution under prompt corrective action provisions	$ 4,271,000	6.0%	$ 4,455,000	6.0%
Minimum regulatory requirement	$ 2,847,000	4.0%	$ 2,970,000	4.0%
Total Risk-Based Capital Ratio				
AltaPacific Bank	$ 27,539,000	38.7%	$ 27,072,000	36.5%
Minimum requirement for "Well-Capitalized" institution under prompt corrective action provisions	$ 7,118,000	10.0%	$ 7,425,000	10.0%
Minimum regulatory requirement	$ 5,694,000	8.0%	$ 5,940,000	8.0%

12. RELATED PARTY TRANSACTIONS

Loans

During the normal course of business, the Company enters into transactions with related parties, including Directors, executive officers and their affiliates. These transactions include borrowings from the Company with substantially the same terms, including rates and collateral, as loans to unrelated parties. The following is a summary of the aggregate activity involving related party borrowers for the years ended December 31, 2010 and 2009:

	December 31,	
	2010	2009
Balance, beginning of period	$ 145,000	$ 40,000
Disbursements	100,000	210,000
Amounts repaid	(245,000)	(105,000)
Balance, December 31	$ -	$ 145,000
Undisbursed commitments to related parties, December 31	$ 1,680,000	$ 1,535,000

Deposits

At December 31, 2010 and 2009, the Company's deposits from related parties totaled $3,588,000 and $7,267,000, respectively.

13. EMPLOYEE BENEFIT PLANS

Profit Sharing Plan

In 2006, the Company adopted a 401(k) Plan (the "Plan") covering substantially all employees 21 years of age or older with 3 months of service. Eligible employees may elect to make tax deferred contributions up to the maximum amount allowed by law. The Plan is a Safe Harbor Plan and currently matches employee contributions up to 4% of compensation. In addition, the Company may make an annual discretionary profit-sharing contribution. Employee contributions, Company matching contributions and related earnings are always 100% vested. Company profit-sharing contributions and related earnings vest 20% a year, with 100% vesting after five years of service. The Company's expense for matching contributions was $51,000 and $40,000 for the years ended December 31, 2010 and 2009, respectively. The Company did not make a discretionary profit-sharing contribution for the years ended December 31, 2010 or 2009.

14. OTHER EXPENSES

Other expenses for the years ended December 31, 2010 and 2009 consisted of the following:

	2010	2009
Data processing	$ 325,000	$ 292,000
Professional fees	173,000	118,000
Regulatory assessments	120,000	98,000
Share-based expense – Directors	82,000	135,000
Stationery and supplies	48,000	48,000
Correspondent banking fees	42,000	39,000
Insurance	30,000	29,000
Advertising and marketing	30,000	26,000
OREO	26,000	
Director fees	21,000	
Telephone	20,000	17,000
Travel	17,000	
Shareholder services	12,000	14,000
Provision for the reserve for unfunded commitments		10,000
Other	133,000	170,000
	$ 1,079,000	$ 996,000

15. FAIR VALUE MEASUREMENTS

Fair Value of Financial Instruments

The estimated carrying fair values of the Company's financial instruments are as follows:

	December 31, 2010		December 31, 2009	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:				
Cash and due from banks	$ 790,000	$ 790,000	$ 671,000	$ 671,000
Federal funds sold	1,510,000	1,510,000	1,020,000	1,020,000
Interest-bearing deposits in banks	3,287,000	3,287,000	10,091,000	10,091,000
Available-for-sale investment securities	9,645,000	9,645,000	9,217,000	9,217,000
Loans, net	60,132,000	60,321,000	60,268,000	59,980,000
Federal Reserve Bank stock	775,000	775,000		
Federal Home Loan Bank stock	379,000	379,000	358,000	358,000
Accrued interest receivable	282,000	282,000	304,000	304,000
Financial liabilities:				
Deposits	$ 47,139,000	$ 47,315,000	$ 50,557,000	$ 50,533,000
Short-term borrowings	5,000,000	5,000,000	7,500,000	7,500,000
Accrued interest payable	14,000	14,000	21,000	21,000

15. FAIR VALUE MEASUREMENTS (Continued)

Fair Value of Financial Instruments (Continued)

These estimates do not reflect any premium or discount that could result from offering the Company's entire holdings of a particular financial instrument for sale at one time, nor do they attempt to estimate the value of anticipated future business related to the instruments. In addition, the tax ramifications related to the realization of unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of these estimates.

The following methods and assumptions were used to estimate the fair value of financial instruments. For cash and due from banks, interest-bearing deposits in banks, Federal funds sold, variable-rate loans, accrued interest receivable and payable, Federal Reserve Bank stock, Federal Home Loan Bank stock, demand deposits and short-term borrowings, the carrying amount is estimated to be fair value. For investment securities, fair values are based on quoted market prices, quoted market prices for similar securities and indications of value provided by brokers. The fair values for fixed-rate loans are estimated using discounted cash flow analyses, using interest rates currently being offered at each reporting date for loans with similar terms to borrowers of comparable creditworthiness. Fair values for fixed-rate certificates of deposit are estimated using discounted cash flow analyses using interest rates offered at each reporting date by the Company for certificates with similar remaining maturities. The fair values of commitments are estimated using the fees currently charged to enter into similar agreements and are not significant and, therefore, not included in the above table.

Fair Value Hierarchy

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

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

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

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

15. FAIR VALUE MEASUREMENTS (Continued)

Fair Value Hierarchy (Continued)

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

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

Assets Recorded at Fair Value

The following tables present information about the Company's assets and liabilities measured at fair value on a recurring and nonrecurring basis:

Recurring Basis

Description	Fair Value	Level 1	Level 2	Level 3
December 31, 2010				
Available-for-sale investment securities:				
Mortgage-backed securities	$ 9,645,000		$ 9,645,000	
Total assets measured at fair value on a recurring basis	$ 9,645,000	$ -	$ 9,645,000	$ -
December 31, 2009				
Available-for-sale investment securities:				
Mortgage-backed securities	$ 9,217,000		$ 9,217,000	
Total assets measured at fair value on a recurring basis	$ 9,217,000	$ -	$ 9,217,000	$ -

15. FAIR VALUE MEASUREMENTS (Continued)

Assets Recorded at Fair Value (Continued)

Recurring Basis (Continued)

Fair values for mortgage-backed securities are based on quoted market prices for similar securities. During the year ended December 31, 2010, there were no significant transfers in or out of Levels 1 and 2 or changes in the valuation techniques used.

Non-recurring Basis

The Company may be required, from time to time, to measure certain assets at fair value on a non-recurring basis. These include assets that are measured at the lower of cost or market value that were recognized at fair value which was below cost at the reporting date.

Description	Fair Value	Level 1	Level 2	Level 3
December 31, 2010				
Other real estate owned	$ 781,000	$ -	$ -	$ 781,000
December 31, 2009				
Impaired loan	$ 1,185,000	$ -	$ -	$ 1,185,000

Other real estate owned – The fair value of other real estate owned is based on the fair value of the property less estimated costs to sell. If the Company determines that the fair value of other real estate owned is less than its carrying value it is adjusted through impairment expense charged to noninterest expenses. There were no losses recognized for write-down of other real estate owned for the year ended December 31, 2010, however losses totaling $613,000 were recognized as impairment charge during the year ended December 31, 2010 for the period of time this property was collateral for a loan that was considered impaired. These losses were recorded as charge-offs to the allowance for loan losses prior to the property being acquired through foreclosure.

Impaired loans – The fair value of impaired loans is based on the fair value of the collateral for all collateral dependent loans. The impaired loan included as of December 31, 2009 above is collateral dependent and was adjusted to fair value based on the estimated fair value of the underlying collateral, less estimated selling costs. If the Company determines that the value of an impaired loan is less than the recorded investment in the loan, the carrying value is adjusted through a charge-off recorded through the allowance for loan losses. Total losses of $459,000 were recognized as impairment charges during the year ended December 31, 2009 related to the above impaired loan. This impaired loan was categorized as Level 3 due to ongoing real estate market conditions resulting in inactive market data, which in turn required the use of unobservable inputs and assumptions in fair value measurements.