

ALTA PACIFIC BANCORP

**CONSOLIDATED FINANCIAL STATEMENTS
WITH
INDEPENDENT AUDITORS' REPORT**

DECEMBER 31, 2013 AND 2012

ALTAPACIFIC BANCORP
DECEMBER 31, 2013 AND 2012

CONTENTS

	Page
Independent Auditors' Report	1
 Financial Statements	
Consolidated Balance Sheets December 31, 2013 and 2012.....	2
Consolidated Statements of Income For the years ended December 31, 2013 and 2012.....	3
Consolidated Statements of Comprehensive Income (Loss) For the years ended December 31, 2013 and 2012.....	4
Consolidated Statement of Changes in Shareholders' Equity For the years ended December 31, 2013 and 2012.....	5
Consolidated Statements of Cash Flows For the years ended December 31, 2013 and 2012.....	6
 Notes to Consolidated Financial Statements	 7



INDEPENDENT AUDITORS' REPORT

Board of Directors and Shareholders of
AltaPacific Bancorp
Santa Rosa, California

We have audited the accompanying consolidated financial statements of AltaPacific Bancorp, which are comprised of the consolidated balance sheets as of December 31, 2013 and 2012, and the related statements of income, comprehensive income, changes in shareholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these 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 financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the 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 AltaPacific Bancorp as of December 31, 2013 and 2012, and the results of its operations and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

Vavrinek, Trine, Day & Co., LLP

Rancho Cucamonga, California
March 25, 2014

ALTAPACIFIC BANCORP
CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2013 AND 2012

	2013	2012
ASSETS		
Cash and due from banks	\$ 6,079,000	\$ 3,135,000
Federal funds sold	-	18,670,000
Cash and Cash Equivalents	6,079,000	21,805,000
Available-for-sale investment securities	74,872,000	81,408,000
Loans, less allowance for loan losses of \$2,070,000 in 2013, and \$1,659,000 in 2012	141,162,000	97,172,000
Premises and equipment, net	1,092,000	1,469,000
Other real estate owned (OREO)	591,000	591,000
Bank owned life insurance	6,916,000	5,208,000
Accrued interest receivable and other assets	8,188,000	8,624,000
Total Assets	\$ 238,900,000	\$ 216,277,000
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities		
Deposits:		
Noninterest-bearing deposits	\$ 34,016,000	\$ 28,498,000
Interest-bearing deposits	134,979,000	133,442,000
Total Deposits	168,995,000	161,940,000
Other borrowings	20,000,000	5,000,000
Accrued interest payable and other liabilities	1,922,000	1,940,000
Total Liabilities	190,917,000	168,880,000
Commitments and Contingencies (Note 11)	-	-
Stockholders' Equity		
Preferred stock, no par value, 10,000,000 shares authorized; none issued or outstanding	-	-
Common stock, no par value, 40,000,000 shares authorized; 5,551,294 and 5,392,448 shares issued and outstanding for 2013 and 2012, respectively	45,324,000	46,117,000
Retained earnings	1,739,000	302,000
Accumulated other comprehensive income	920,000	978,000
Total Stockholders' Equity	47,983,000	47,397,000
Total Liabilities and Stockholders' Equity	\$ 238,900,000	\$ 216,277,000

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

ALTAPACIFIC BANCORP

**CONSOLIDATED STATEMENTS OF INCOME
FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012**

	2013	2012
Interest Income		
Interest and fees on loans	\$ 9,028,000	\$ 8,663,000
Interest on Federal funds sold	22,000	34,000
Interest on available-for-sale investment securities	2,090,000	2,062,000
Interest on deposits with other financial institutions	-	1,000
Total Interest Income	11,140,000	10,760,000
Interest Expense		
Interest expense on deposits	833,000	923,000
Interest on short-term borrowings	72,000	70,000
Total Interest Expense	905,000	993,000
Net Interest Income	10,235,000	9,767,000
Provision for Loan Losses	410,000	300,000
Net Interest Income After Provision for Loan Losses	9,825,000	9,467,000
Noninterest Income		
Service charges and fees	121,000	102,000
Bank owned life insurance	208,000	157,000
Bargain purchase gain	-	886,000
Gain on sale of investment securities	84,000	-
Miscellaneous income	15,000	26,000
Other-Than-Temporary Impairment Loss		
Total impairment loss	-	(581,000)
Loss recognized in other comprehensive income	-	261,000
Total Noninterest Income	428,000	851,000
Noninterest Expense		
Salaries and other employee benefits	4,976,000	4,752,000
Occupancy and equipment	1,109,000	1,072,000
Other	1,816,000	2,089,000
Total Noninterest Expense	7,901,000	7,913,000
Net Income Before Provision for Income Taxes	2,352,000	2,405,000
Provision for Income Taxes	915,000	624,000
Net Income	\$ 1,437,000	\$ 1,781,000
Income Per Share		
Basic	\$ 0.26	\$ 0.33
Diluted	\$ 0.26	\$ 0.33
Weighted average number of shares outstanding - basic	5,613,978	5,471,887
Weighted average number of shares outstanding - diluted	5,632,724	5,471,887

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

ALTAPACIFIC BANCORP

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME/LOSS
FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012**

	2013	2012
Net income	\$ 1,437,000	\$ 1,781,000
Other Comprehensive Income (Loss):		
Unrealized (losses) gains on securities available-for-sale	(14,000)	3,466,000
Reclassification of realized gains on sale of available-for-sale securities included in net income	(84,000)	-
Reclassification of other-than-temporary impairment losses on available-for-sale securities included in net income	-	320,000
	(98,000)	3,786,000
Income tax effect relating to available-for-sale securities	40,000	(1,552,000)
Total Other Comprehensive (Loss) Income	(58,000)	2,234,000
Total Comprehensive Income	\$ 1,379,000	\$ 4,015,000

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

ALTAPACIFIC BANCORP

**CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012**

	Common Stock		Retained (Deficit) Earnings	Accumulated Other	Total Stockholders' Equity
	Shares Outstanding	Amount		Comprehensive (Loss) Income	
Balance, January 1, 2012	3,444,114	\$ 29,069,000	\$ (1,479,000)	\$ (1,256,000)	\$ 26,334,000
Net income	-	-	1,781,000	-	1,781,000
Share-based compensation expense	-	83,000	-	-	83,000
Issuance of common stock	2,034,434	17,440,000	-	-	17,440,000
Purchase and retirement of stock	(86,100)	(475,000)	-	-	(475,000)
Unrealized gain on available-for-sale investment securities, net of tax	-	-	-	2,234,000	2,234,000
Balance, December 31, 2012	5,392,448	\$ 46,117,000	\$ 302,000	\$ 978,000	\$ 47,397,000
Net income	-	-	1,437,000	-	1,437,000
Share-based compensation expense	-	77,000	-	-	77,000
Issuance of common stock	264,155	-	-	-	-
Purchase and retirement of stock	(105,309)	(870,000)	-	-	(870,000)
Unrealized loss on available-for-sale investment securities, net of tax	-	-	-	(58,000)	(58,000)
Balance, December 31, 2013	<u>5,551,294</u>	<u>\$ 45,324,000</u>	<u>\$ 1,739,000</u>	<u>\$ 920,000</u>	<u>\$ 47,983,000</u>

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

ALTAPACIFIC BANCORP

**CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012**

	2013	2012
Cash Flows from Operating Activities		
Net income	\$ 1,437,000	\$ 1,781,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	410,000	300,000
Provision for OREO writedown	-	175,000
Other than temporary impairment loss	-	320,000
Depreciation and amortization, net	1,344,000	422,000
(Gain) Loss on disposal of premises and equipment	(3,000)	28,000
Gain on sale of investment securities	(84,000)	-
Deferred loan origination costs and fees, net	369,000	108,000
Share-based compensation	77,000	83,000
Bargain purchase gain	-	(886,000)
Deferred tax expense	110,000	203,000
Increase in cash surrender value of life insurance	(208,000)	(157,000)
Decrease (increase) in accrued interest receivable and other assets	402,000	(168,000)
(Decrease) increase in accrued interest payable and other liabilities	(20,000)	1,030,000
Net Cash Flows Provided by Operating Activities	3,834,000	3,239,000
Cash Flows from Investing Activities		
Cash acquired in acquisition	-	7,796,000
Purchase of life insurance	(1,500,000)	-
Net decrease in interest-bearing deposits in banks	-	249,000
Purchase of available-for-sale investment securities	(21,205,000)	(34,885,000)
(Redemption) purchase of Federal Reserve Bank stock	44,000	(556,000)
(Purchase) redemption of Federal Home Loan Bank stock	(78,000)	150,000
Proceeds from sale of available for sale securities	6,223,000	-
Proceeds from principal payments of mortgage-backed securities	20,135,000	20,324,000
(Increase) decrease in loans funded, net	(44,273,000)	15,190,000
Proceeds from sale of OREO	-	224,000
Proceeds from sale of premises and equipment	22,000	-
Purchase of premises and equipment	(113,000)	(367,000)
Net Cash Flows (Used in) Provided by Investing Activities	(40,745,000)	8,125,000
Cash Flows from Financing Activities		
Increase in demand and money market deposits, net	13,676,000	13,857,000
Decrease in time deposits, net	(6,621,000)	-
Repurchase of common stock	(870,000)	(475,000)
Proceeds from other borrowings	15,000,000	-
Repayment of other borrowings	-	(7,000,000)
Net Cash Flows Provided by Financing Activities	21,185,000	6,382,000
Net (Decrease) Increase in Cash and Cash Equivalents	(15,726,000)	17,746,000
Cash and Cash Equivalents, Beginning of Year	21,806,000	4,060,000
Cash and Cash Equivalents, End of Year	\$ 6,080,000	\$ 21,806,000
Supplemental Cash Flow Information:		
Interest paid	\$ 906,000	\$ 938,000
Taxes paid	\$ 1,207,000	\$ 150,000

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

ALTAPACIFIC BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting and reporting policies of AltaPacific Bancorp (the "Company") are in accordance with accounting principles generally accepted in the United States of America and conform to practices within the banking industry. A summary of the accompanying consolidated financial statements follows:

Nature of Operation

AltaPacific Bancorp is a California corporation registered as a bank holding company under the Bank Holding Company Act of 1956, as amended, and is headquartered in Santa Rosa, California. The Company was incorporated in March, 2010, and subsequently acquired all of the outstanding shares of AltaPacific Bank (the "Bank"). The formation of the bank holding company provides the Company and the Bank greater flexibility in terms of operation, expansion, and diversification.

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 (FDIC) up to applicable legal limits. The Bank is headquartered in Santa Rosa, California, and also has branch offices in Rancho Cucamonga, and Covina, California. The Bank provides products and services to customers who are predominately small to middle-market business, professionals, and not-for-profit organizations.

Generally, deposits are insured by the FDIC up to \$250,000 per depositor. Through December 31, 2012, all noninterest-bearing transaction accounts are fully guaranteed by the FDIC for the entire amount in the account.

Principles of Consolidation

The accounting and reporting policies of AltaPacific Bancorp and its subsidiary AltaPacific Bank (collectively, 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.

ALTAPACIFIC BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Operating Segments

While the Company's executive officers monitor the revenue streams of the various products and services, operations are managed and financial performance is evaluated on a Company-wide basis. Operating results are not reviewed by senior management to make resource allocation or performance decisions. Accordingly, all of the financial service operations are considered by management to be aggregated in one reportable operating segment.

Reclassifications

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

Subsequent Events

The Company has evaluated subsequent events for recognition and disclosure through March 25, 2014, 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. 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. The allowance for loan losses, deferred tax assets, and fair values of financial instruments are particularly subject to change.

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, to the extent losses are not considered other than temporary, 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.

ALTAPACIFIC BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Investment Securities, (Continued)

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, 2013 and 2012, all securities are classified as available-for-sale and there were no transfers between categories for the years ended December 31, 2013 and 2012.

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.

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 their outstanding principal balances reduced by any charge-offs or specific valuation accounts and net of any deferred fees or costs on originated loans, or unamortized premiums or discounts on purchased loans. 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 collectability 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 collectability of principal is not in doubt, are applied first to earned but unpaid interest and then to principal. Generally, loans are placed on non-accrual status when they are 90 days past due. Past due status is based on the contractual terms of the loan. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured. The Company's policy for placing loans on nonaccrual status, recording payments received on nonaccrual loans, resuming accrual of interest, and determining past due or delinquency status does not differ by portfolio segment, nor does it differ for loans modified in troubled debt restructurings.

ALTAPACIFIC BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Loans, (Continued)

All classified loans are evaluated for impairment and are considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due (including both principal and interest) in accordance with the contractual terms of the loan agreement. The policy for recognizing interest on impaired loans is the same as the policy described above and does not differ by portfolio segment.

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 below.

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.

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 uncollectability 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 Company 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 Company 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.

ALTAPACIFIC BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Allowance for Loan Losses, (Continued)

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 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 Company include commercial, commercial real estate construction (including land and development loans) commercial real estate mortgage, installment, and home equity lines of credit. 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.

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 do not differ by portfolio segment, and 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.

ALTAPACIFIC BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Allowance for Loan Losses, (Continued)

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.

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.

Consumer 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.

ALTAPACIFIC BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Allowance for Loan Losses, (Continued)

Consumer Other: 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.

There were no significant changes to the Company's accounting policies or methodologies with respect to the allowance for loan losses from the prior year.

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.

ALTAPACIFIC BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

NOTE 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, 2013 and 2012, the Company owned \$1,104,000 and \$1,026,000, respectively, of FHLB stock. At December 31, 2013 and 2012, the Company owned \$1,319,000 and \$1,362,000, respectively, of FRB stock.

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.

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. If fair value declines subsequent to foreclosure, a valuation allowance is recorded through expense. Operating costs after acquisition are expensed.

Bank Owned Life Insurance

The Bank has purchased life insurance policies on certain key executives. Bank 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.

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.

ALTAPACIFIC BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

NOTE 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, 2013.

Earnings Per Share (EPS)

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. Stock options totaling 3,828 and 571,956 for the years ended December 31, 2013 and 2012, respectively, were considered anti-dilutive and were excluded from the computation of diluted earnings per share because the assumed proceeds from exercise price, tax benefits, and average future compensation exceeded the average market price of the Company's common stock.

Share-Based Compensation

The Company has one share-based compensation plan, the Atlantic Pacific Bank 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 1,052,931 shares of the Company's common stock of which 384,128 were available for future grants at December 31, 2013. 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.

ALTAPACIFIC BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Share-Based Compensation, (Continued)

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 account 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 the Company's common stock over a preceding period commensurate with the expected term of the option. 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. 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.

Fair Value Measurement

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 and minimize the use of unobservable inputs when measuring fair value. That guidance describes three levels of inputs that may be used to measure fair value:

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 an entity's own assumptions about the factors that market participants would use in pricing an asset or liability

See Note 18 for more information and disclosures relating to the Company's fair value measurements.

ALTAPACIFIC BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

NOTE 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 or 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. Total comprehensive income or loss and the components of accumulated other comprehensive income or loss is presented in the consolidated statements of comprehensive income (loss).

Adoption of New Accounting Standards

In February 2013, the Financial Accounting Standards Board issued Accounting Standards Update 2013-02, Comprehensive Income ("Topic 220") - Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income ("ASU 2013-02"). This ASU requires an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under Generally Accepted Accounting Principles ("GAAP") to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required under GAAP that provide additional detail about those amounts. ASU 2013-02 is effective prospectively for annual and interim periods beginning after December 15, 2012, for public entities and annual periods beginning after December 15, 2013, for nonpublic entities. The adoption of this ASU did not have a material impact on the Bank's financial position, results of operations, or cash flows.

NOTE 2 - ACQUISITIONS

Stellar Business Bank Acquisition

The Company acquired all the assets and assumed all the liabilities of Stellar Business Bank (SBB) in exchange for the Bancorp stock. The Company issued 2,034,434 shares of Bancorp common stock with a fair value of \$8.57 per share for a total transaction value of approximately \$17,440,000. The Company recorded a bargain purchase gain of \$886,000 as a result of the acquisition primarily due to the fair value of assets acquired being higher than originally estimated. SBB operated one branch in Covina, California. The Company acquired SBB to expand the Company's presence in Southern California, grow and diversify its asset base, improve earnings opportunities, and increase liquidity for the Company's stock.

ALTAPACIFIC BANCORP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

NOTE 2 - ACQUISITIONS, (CONTINUED)

Stellar Business Bank Acquisition, (Continued)

The acquisition of SBB is accounted for under the acquisition method of accounting. The acquired assets, assumed liabilities and identifiable intangible assets are recorded at their respective acquisition date fair values. Fair values are preliminary and subject to refinement for up to one year after the closing date of the merger as additional information regarding the closing date fair values become available.

The following table represents the assets acquired and liabilities assumed of SBB as of February 17, 2012, and the provisional fair value adjustments and amounts recorded by the Company in 2012, under the acquisition method of accounting:

	SBB Book Value	Fair Value Adjustments	Fair Value
Assets Required			
Cash and cash equivalents	\$ 1,021,000	\$ -	\$ 1,021,000
Federal funds sold	6,775,000	-	6,775,000
Investments	23,102,000	-	23,102,000
Loans, gross	55,977,000	(3,054,000)	52,923,000
Allowance for loan losses	(713,000)	713,000	-
Fixed assets	819,000	-	819,000
Other real estate owned	221,000	-	221,000
Deferred tax assets	-	2,910,000	2,910,000
Other assets	1,463,000	1,100,000	2,563,000
Total Assets Acquired	\$ 88,665,000	\$ 1,669,000	\$ 90,334,000
Liabilities Assumed			
Deposits	\$ 71,683,000	\$ -	\$ 71,683,000
Other liabilities	325,000	-	325,000
Total Liabilities Assumed	72,008,000	-	72,008,000
Excess of assets acquired Over Liabilities Assumed			
Bargain Purchase Gain	16,657,000	783,000	17,440,000
	-	886,000	886,000
	\$ 88,665,000	\$ 1,669,000	\$ 90,334,000
Stock issued			17,440,000
Goodwill recognized			\$ -

ALTAPACIFIC BANCORP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

NOTE 2 - ACQUISITIONS, (CONTINUED)

Stellar Business Bank Acquisition, (Continued)

In many cases, the fair values of assets acquired and liabilities assumed were determined by estimating the cash flows expected to result from those assets and liabilities and discounting them at appropriate market rates. The most significant category of assets for which this procedure was used was that of acquired loans. The excess of expected cash flows above the fair value of the majority of loans will be accreted to interest income over the remaining lives of the loans in accordance with FASB Accounting Standards Codification (ASC) 310-20 (formerly SFAS 91).

Certain loans, for which specific credit-related deterioration, since origination, was identified, are recorded at fair value, reflecting the present value of the amounts expected to be collected. Income recognition on these "purchased credit-impaired" loans is based on a reasonable expectation about the timing and amount of cash flows to be collected. Acquired loans deemed impaired and considered collateral dependent, with the timing of the sale of loan collateral indeterminate, remain on non-accrual status and have no accretable yield.

For loans acquired from SBB, the outstanding balance, expected cash flows to be collected and fair value as of the respective acquisition dates were as follows:

	Purchased Credit Impaired	All Other Acquired Loans
Outstanding Balance	\$ 1,527,000	\$ 54,450,000
Cash flows not expected to be collected	484,000	-
Expected cash flows	1,043,000	54,450,000
Interest component of expected cash flows	42,000	2,528,000
Fair value of acquired loans	<u>\$ 1,001,000</u>	<u>\$ 51,922,000</u>

In accordance with generally accepted accounting principles, there was no carryover of the allowance for loan losses that had been previously recorded by SBB.

The Bank recorded a deferred income tax asset of \$2,910,000 related to SBB's net operating loss carry-forward, as well as other tax attributes of SBB, along with the effects of fair value adjustments resulting from applying the acquisition method of accounting.

The fair value of savings and transaction deposit accounts acquired from SBB were assumed to approximate their carrying value, as these accounts have no stated maturity and are payable on demand.

ALTAPACIFIC BANCORP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

NOTE 2 - ACQUISITIONS, (CONTINUED)

Stellar Business Bank Acquisition, (Continued)

The operating results of the Company for the year ending December 31, 2012, includes the operating results of SBB since the acquisition date of February 17, 2012. The following summarizes the net interest and other income, net income, and earnings per share as if the merger with SBB was effective as of the beginning of the comparable prior annual reporting period presented. There was no material, nonrecurring adjustments to the proforma net interest and other income, net income, and earnings per share presented below:

	Year Ended December 31, 2012
Net interest and other income	\$ 11,203,000
Net income	399,000
Basic earnings per share	0.07
Diluted earnings per share	0.07

NOTE 3 - INVESTMENT SECURITIES

The amortized cost and estimated fair value of available-for-sale investment securities at December 31, 2013 consisted of the following:

December 31, 2013	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Corporate securities	\$ 29,047,000	\$ 1,483,000	\$ (40,000)	\$ 30,490,000
Mortgage-backed securities:				
Agency	26,261,000	148,000	(104,000)	26,305,000
Non-agency	18,005,000	450,000	(378,000)	18,077,000
Total Securities	\$ 73,313,000	\$ 2,081,000	\$ (522,000)	\$ 74,872,000

ALTAPACIFIC BANCORP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

NOTE 3 - INVESTMENT SECURITIES (CONTINUED)

The amortized cost and estimated fair value of available-for-sale investment securities at December 31, 2012 consisted of the following:

<u>December 31, 2012</u>	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Corporate securities	\$ 22,831,000	\$ 1,624,000	\$ (1,000)	\$ 24,454,000
Mortgage-backed securities:				
Agency	39,377,000	247,000	(246,000)	39,378,000
Non-agency	17,543,000	418,000	(385,000)	17,576,000
Total Securities	<u>\$ 79,751,000</u>	<u>\$ 2,289,000</u>	<u>\$ (632,000)</u>	<u>\$ 81,408,000</u>

Net unrealized losses on available-for-sale investment securities totaling \$98,000 were recorded net of \$40,000 in tax benefits, within shareholders' equity for the year ended December 31, 2013. Net unrealized gains on available-for-sale investment securities totaling \$3,786,000 were recorded net of \$1,552,000 in tax expense, within shareholders' equity for the year ended December 31, 2012. For the years ended December 31, 2013 and 2012, proceeds from the sales of securities available for sale were \$6,223,000 and \$0-, respectively. There were no calls, or transfers of available-for-sale investment securities for the years ended December 31, 2013 or 2012.

Investment securities with unrealized losses at December 31, 2013 and 2012 are summarized and classified according to the duration of the loss period as follows:

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
December 31, 2013						
Corporate securities	\$ 6,460,000	\$ (40,000)	\$ -	\$ -	\$ 6,460,000	\$ (40,000)
Mortgage-backed securities:						
Agency	8,696,000	(67,000)	3,067,000	(37,000)	11,763,000	(104,000)
Non-agency	2,946,000	(31,000)	6,698,000	(347,000)	9,644,000	(378,000)
	<u>\$ 18,102,000</u>	<u>\$ (138,000)</u>	<u>\$ 9,765,000</u>	<u>\$ (384,000)</u>	<u>\$ 27,867,000</u>	<u>\$ (522,000)</u>
December 31, 2012						
Corporate securities	\$ 1,799,000	\$ (1,000)	\$ -	\$ -	\$ 1,799,000	\$ (1,000)
Mortgage-backed securities:						
Agency	13,341,000	(117,000)	9,930,000	(129,000)	23,271,000	(246,000)
Non-agency	5,274,000	(119,000)	2,358,000	(266,000)	7,632,000	(385,000)
	<u>\$ 20,414,000</u>	<u>\$ (237,000)</u>	<u>\$ 12,288,000</u>	<u>\$ (395,000)</u>	<u>\$ 32,702,000</u>	<u>\$ (632,000)</u>

ALTAPACIFIC BANCORP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

NOTE 3 - INVESTMENT SECURITIES, (CONTINUED)

The Company held one corporate security which was in an unrealized loss position as of December 31, 2013, and had been in an unrealized loss position for less than 12 months. The Company held 20 agency residential mortgage-backed securities of which nine were in an unrealized loss position as of December 31, 2013, and 17 non-agency residential mortgage-backed securities of which 10 were in an unrealized loss position as of December 31, 2013. Three agency residential mortgage-backed securities had been in an unrealized loss position for less than 12 months and eight non-agency residential 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. For all securities in an unrealized loss position, based on management's 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, 2013.

The Company held one corporate security which was in an unrealized loss position as of December 31, 2012, and had been in an unrealized loss position for less than 12 months. The Company held 30 agency residential mortgage-backed securities of which 18 were in an unrealized loss position as of December 31, 2012, and 15 non-agency residential mortgage-backed securities of which eight were in an unrealized loss position as of December 31, 2012. Six agency residential mortgage-backed securities had been in an unrealized loss position for less than 12 months and three non-agency residential 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. Upon completion of the December 31, 2012 analysis, management determined there was other-than-temporary impairment on four of these securities. These four securities had unrealized losses of \$581,000 in 2012, of which \$320,000 was recorded as expense and \$261,000 was recorded in other comprehensive loss. These four securities remained classified as available for sale at December 31, 2012. For all securities in an unrealized loss position other than these four securities, based on management's 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, 2012.

ALTAPACIFIC BANCORP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

NOTE 3 - INVESTMENT SECURITIES, (CONTINUED)

The amortized cost and estimated fair value of available-for-sale investment securities at December 31, 2013, by contractual maturity are shown below.

	Amortized Cost	Estimated Fair Value
Corporate securities		
Less than one year	\$ 2,499,000	\$ 2,502,000
One through five years	9,255,000	9,884,000
Five through ten years	17,293,000	18,104,000
	<u>29,047,000</u>	<u>30,490,000</u>
Mortgage-backed securities		
Five through ten years	1,365,000	1,399,000
After ten years	24,896,000	24,906,000
	<u>26,261,000</u>	<u>26,305,000</u>
Non-agency		
After ten years	18,005,000	18,077,000
	<u>\$ 73,313,000</u>	<u>\$ 74,872,000</u>

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 \$26,261,000 and estimated fair values totaling \$26,304,000 were pledged to secure borrowings with the Federal Home Loan Bank at December 31, 2013. Investment securities with amortized cost totaling \$39,377,000 and estimated fair values totaling \$39,378,000 were pledged to secure borrowings with the Federal Home Loan Bank at December 31, 2012 (see Note 10).

ALTAPACIFIC BANCORP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

NOTE 4 - LOANS

Outstanding loans are summarized below:

	December 31,	
	2013	2012
Commercial	\$ 8,630,000	\$ 8,843,000
Real estate:		
Construction	42,822,000	27,064,000
Mortgage	88,814,000	57,235,000
Installment	3,051,000	4,837,000
Home equity lines of credit	832,000	1,400,000
Loans Receivable	144,149,000	99,379,000
Allowances for loan losses	(2,070,000)	(1,659,000)
Net deferred loan origination fees	(917,000)	(548,000)
Loans Receivable, net	<u>\$ 141,162,000</u>	<u>\$ 97,172,000</u>

Salaries and employee benefits totaling \$215,000 and \$138,000 were deferred as loan origination costs for the years ended December 31, 2013 and 2012, respectively.

As of December 31, 2013, the Company's loans included the remaining unaccreted discount of \$1,286,000 related to the acquisition of SBB.

Certain loans are pledged as collateral for available borrowings with the FHLB. Pledged loans totaled \$76,564,000 and \$70,746,000 at December 31, 2013 and 2012, respectively (see Note 10).

Purchased Credit Impaired Loans (PCI)

The Company has purchased loans, for which there was, at acquisition, evidence of deterioration of credit quality since origination and it was probable, at acquisition, that all contractually required payments would not be collected. The Company has not recorded an allowance for loan and lease losses for these PCI loans. The carrying amount of those loans is as follows:

	December 31,	
	2013	2012
Real estate	<u>\$ 110,000</u>	<u>\$ 157,000</u>

ALTAPACIFIC BANCORP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

NOTE 4 – LOANS (CONTINUED)

Accrutable yield, or income expected to be collected, is as follows:

	December 31,	
	2013	2012
Balance at January 1	\$ 17,000	\$ -
New loans purchased	-	42,000
Accretion of income	(7,000)	(12,000)
Disposals	-	(13,000)
Balance at January 1	<u>\$ 10,000</u>	<u>\$ 17,000</u>

NOTE 5 - ALLOWANCE FOR LOAN LOSSES

A summary of the changes in the allowance for loan losses follows as of December 31:

	2013	2012
Balance, beginning of year	\$ 1,659,000	\$ 1,300,000
Provision for credit losses	410,000	300,000
Loans charged-off	-	(32,000)
Recoveries of loans previously charged off	1,000	91,000
Balance, end of year	<u>\$ 2,070,000</u>	<u>\$ 1,659,000</u>

ALTAPACIFIC BANCORP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

NOTE 5 - ALLOWANCE FOR LOAN LOSSES (CONTINUED)

The following table presents the activity in the allowance for loan losses for the year 2013, and the recorded investment in loans and impairment method as of December 31, 2013, by portfolio segment:

December 31, 2013	Commercial	Real Estate Construction	Real Estate Mortgage	Installment	Home Equity Lines of Credit	Total
Allowance for Loan Losses:						
Beginning of Year	\$ 372,000	\$ 644,000	\$ 563,000	\$ 63,000	\$ 17,000	\$ 1,659,000
Provisions (credits)	(247,000)	29,000	672,000	(39,000)	(5,000)	410,000
Charge-offs	-	-	-	-	-	-
Recoveries	1,000	-	-	-	-	1,000
End of Year	<u>\$ 126,000</u>	<u>\$ 673,000</u>	<u>\$ 1,235,000</u>	<u>\$ 24,000</u>	<u>\$ 12,000</u>	<u>\$ 2,070,000</u>
Reserves:						
Specific	\$ -	\$ -	\$ 240,000	\$ -	\$ -	\$ 240,000
General	126,000	673,000	995,000	24,000	12,000	1,830,000
Acquired with deteriorated credit quality	-	-	-	-	-	-
	<u>\$ 126,000</u>	<u>\$ 673,000</u>	<u>\$ 1,235,000</u>	<u>\$ 24,000</u>	<u>\$ 12,000</u>	<u>\$ 2,070,000</u>
Loans Evaluated for Impairment:						
Individually	\$ -	\$ -	\$ 909,000	\$ -	\$ -	\$ 909,000
Collectively	8,630,000	42,822,000	87,905,000	3,051,000	832,000	143,240,000
Acquired with deteriorated credit quality	-	-	-	-	-	-
	<u>\$ 8,630,000</u>	<u>\$ 42,822,000</u>	<u>\$ 88,814,000</u>	<u>\$ 3,051,000</u>	<u>\$ 832,000</u>	<u>\$144,149,000</u>

ALTAPACIFIC BANCORP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

NOTE 5 - ALLOWANCE FOR LOAN LOSSES (CONTINUED)

The following table presents the activity in the allowance for loan losses for the year 2013, and the recorded investment in loans and impairment method as of December 31, 2012, by portfolio segment:

December 31, 2012	Commercial	Real Estate Construction	Real Estate Mortgage	Installment	Home Equity Lines of Credit	Total
Allowance for Loan Losses:						
Beginning of Year	\$ 145,000	\$ 595,000	\$ 501,000	\$ 38,000	\$ 21,000	\$ 1,300,000
Provisions (credits)	227,000	49,000	3,000	25,000	(4,000)	300,000
Charge-offs	-	-	(32,000)	-	-	(32,000)
Recoveries	-	-	91,000	-	-	91,000
End of Year	<u>\$ 372,000</u>	<u>\$ 644,000</u>	<u>\$ 563,000</u>	<u>\$ 63,000</u>	<u>\$ 17,000</u>	<u>\$ 1,659,000</u>
Reserves:						
Specific	\$ -	\$ -	\$ 240,000	\$ -	\$ -	\$ 240,000
General	372,000	644,000	323,000	63,000	17,000	1,419,000
Acquired with deteriorated credit quality	-	-	-	-	-	-
	<u>\$ 372,000</u>	<u>\$ 644,000</u>	<u>\$ 563,000</u>	<u>\$ 63,000</u>	<u>\$ 17,000</u>	<u>\$ 1,659,000</u>
Loans Evaluated for Impairment:						
Individually	\$ 10,000	\$ -	\$ 958,000	\$ -	\$ -	\$ 968,000
Collectively	8,833,000	27,064,000	56,277,000	4,837,000	1,400,000	98,411,000
Acquired with deteriorated credit quality	-	-	-	-	-	-
	<u>\$ 8,843,000</u>	<u>\$ 27,064,000</u>	<u>\$ 57,235,000</u>	<u>\$ 4,837,000</u>	<u>\$ 1,400,000</u>	<u>\$ 99,379,000</u>

ALTAPACIFIC BANCORP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

NOTE 5 - ALLOWANCE FOR LOAN LOSSES (CONTINUED)

The following table shows the loan portfolio allocated by management's internal risk ratings at December 31, 2013 and 2012:

December 31, 2013	Pass	Special Mention	Substandard	Impaired	Total
Commercial	\$ 8,257,000	\$ 373,000	\$ -	\$ -	\$ 8,630,000
Real estate:					
Construction	42,822,000	-	-	-	42,822,000
Mortgage	87,905,000	-	-	909,000	88,814,000
Installment	3,051,000	-	-	-	3,051,000
Home equity lines of credit	832,000	-	-	-	832,000
	<u>\$ 142,867,000</u>	<u>\$ 373,000</u>	<u>\$ -</u>	<u>\$ 909,000</u>	<u>\$ 144,149,000</u>
December 31, 2012					
Commercial	\$ 8,534,000	\$ 299,000	\$ -	\$ 10,000	\$ 8,843,000
Real estate:					
Construction	27,064,000	-	-	-	27,064,000
Mortgage	56,277,000	-	-	958,000	57,235,000
Installment	4,837,000	-	-	-	4,837,000
Home equity lines of credit	1,400,000	-	-	-	1,400,000
	<u>\$ 98,112,000</u>	<u>\$ 299,000</u>	<u>\$ -</u>	<u>\$ 968,000</u>	<u>\$ 99,379,000</u>

At December 31, 2013 and 2012, there were no loans past due 30 days or more and still accruing. Nonaccrual loans presented by loan class were as follows as of December 31, 2013 and 2012.

	Nonaccrual	
	2013	2012
Commercial	\$ -	\$ 10,000
Real estate:		
Mortgage	110,000	142,000
	<u>\$ 110,000</u>	<u>\$ 152,000</u>

ALTAPACIFIC BANCORP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

NOTE 5 - ALLOWANCE FOR LOAN LOSSES (CONTINUED)

Information relating to individually impaired loans presented by class of loans was as follows as of December 31, 2013 and 2012:

<u>December 31, 2013</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 a Related Allowance					
Recorded					
Real estate	\$ 799,000	\$ 799,000	\$ 240,000	\$ 808,000	\$ 40,000
Without a Related Allowance					
Recorded					
Real estate	270,000	110,000	-	125,000	4,000
Commercial	9,000	-	-	3,000	50,000
	<u>279,000</u>	<u>110,000</u>	<u>-</u>	<u>128,000</u>	<u>54,000</u>
Total	<u>\$ 1,078,000</u>	<u>\$ 909,000</u>	<u>\$ 240,000</u>	<u>\$ 936,000</u>	<u>\$ 94,000</u>
<u>December 31, 2012</u>					
With a Related Allowance					
Recorded					
Real estate	\$ 816,000	\$ 816,000	\$ 240,000	\$ 20,000	\$ 50,000
Without a Related Allowance					
Recorded					
Real estate	305,000	142,000	-	135,000	7,000
Commercial	69,000	10,000	-	31,000	4,000
	<u>374,000</u>	<u>152,000</u>	<u>-</u>	<u>166,000</u>	<u>11,000</u>
Total	<u>\$ 1,190,000</u>	<u>\$ 968,000</u>	<u>\$ 240,000</u>	<u>\$ 186,000</u>	<u>\$ 61,000</u>

There was no interest income included above recognized on a cash basis in 2013 or 2012.

Troubled Debt Restructurings

As of December 31, 2013 and 2012, the Company has recorded investment in troubled debt restructurings of \$799,000 and \$816,000, respectively. The Company has allocated \$240,000 of specific reserves for those loans at December 31, 2013 and 2012, and has not committed to lend additional amounts.

ALTAPACIFIC BANCORP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

NOTE 5 - ALLOWANCE FOR LOAN LOSSES (CONTINUED)

Troubled Debt Restructurings (Continued)

A summary of new activity in troubled debt restructurings (TDR's) presented by loan class follows for the year ended December 31, 2012. TDR's are considered to have defaulted when payments are over 90 days past due. There were no new TDR's in 2013.

December 31, 2012	Number of Contracts	Pre- Modification Investment	Post- Modification Investment
TDR's			
Real estate	1	\$ 816,000	\$ 816,000

The modification of the terms of such real estate loans performed during the year ended December 31, 2012 included an extension of the maturity date at a stated rate of interest lower than the current market rate. The extension was for four years.

There were no TDR's that subsequently defaulted in the last 12 months following their restructure. The TDR's described above increased the allowance for loan losses by \$240,000 and resulted in no charge-offs during the year ending December 31, 2012.

NOTE 6 - PREMISES AND EQUIPMENT

Premises and equipment consisted of the following:

	2013	2012
Furniture, fixtures and equipment	\$ 2,536,000	\$ 2,464,000
Leasehold improvements	1,702,000	1,886,000
	4,238,000	4,350,000
Accumulated depreciation and amortization	(3,146,000)	(2,881,000)
	\$ 1,092,000	\$ 1,469,000

Depreciation and amortization included in occupancy and equipment expense totaled \$471,000 and \$453,000 for the years ended December 31, 2013 and 2012, respectively.

ALTAPACIFIC BANCORP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

NOTE 7 - CORE DEPOSIT INTANGIBLE ASSET

The core deposit intangible asset (CDI) is associated with the acquisition of Stellar Business Bank in 2012. The CDI asset is subject to amortization and is included in other assets on the Company's balance sheet. The following tables summarize the gross carrying amount, accumulated amortization and net carrying amount of CDI and provide an estimate for future amortization as of December 31, 2013.

	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Core deposit intangible	\$ 1,100,000	\$ (354,000)	\$ 746,000
<u>Year Ending</u>			<u>Amount</u>
2014			\$ 148,000
2015			128,000
2016			110,000
2017			94,000
2018			80,000
Thereafter			186,000
Total			\$ 746,000

NOTE 8 - INTEREST-BEARING DEPOSITS

Interest-bearing deposits consisted of the following:

	2013	2012
Savings accounts	\$ 872,000	\$ 338,000
Money market accounts	115,045,000	106,811,000
Interest-bearing demand accounts	2,343,000	2,952,000
Time certificate of deposit accounts under \$100,000	2,613,000	3,640,000
Time certificate of deposit accounts over \$100,000	14,106,000	19,701,000
	\$ 134,979,000	\$ 133,442,000

The maturity of time deposits is as follows:

	2013	2012
Within one year	\$ 15,623,000	\$ 17,670,000
One year to three years	1,096,000	5,671,000
	\$ 16,719,000	\$ 23,341,000

ALTAPACIFIC BANCORP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

NOTE 8 - INTEREST-BEARING DEPOSITS (CONTINUED)

Interest expense recognized on interest-bearing deposits for the years ended December 31, consists of the following:

	<u>2013</u>	<u>2012</u>
Savings and money market accounts	\$ 700,000	\$ 764,000
Interest-bearing demand accounts	2,000	2,000
Time certificate of deposit accounts under \$100,000	19,000	26,000
Time certificate of deposit accounts over \$100,000	112,000	131,000
	<u>\$ 833,000</u>	<u>\$ 923,000</u>

NOTE 9 - INCOME TAXES

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

	<u>2013</u>	<u>2012</u>
Current Taxes:		
Federal	\$ 616,000	\$ 348,000
State	189,000	73,000
	<u>805,000</u>	<u>421,000</u>
Deferred Taxes:		
Federal	(19,000)	201,000
State	129,000	2,000
	<u>110,000</u>	<u>203,000</u>
Income Tax Expense	<u>\$ 915,000</u>	<u>\$ 624,000</u>

The following table reconciles the statutory tax rate to the consolidated effective income tax rate for the years ended December 31:

	<u>2013</u>	<u>2012</u>
Federal tax rate	34.0%	34.0%
State taxes, net of Federal tax benefits	6.7%	4.5%
Bank owned life insurance	-3.0%	-12.5%
Stock option compensation	0.9%	-2.2%
Bargain purchase gain	-	0.9%
Merger Expenses	-	1.2%
Other items, net	0.3%	-
Provision for Income Tax	<u>38.9%</u>	<u>25.9%</u>

ALTAPACIFIC BANCORP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

NOTE 9 - INCOME TAXES (CONTINUED)

Deferred tax assets (liabilities) at December 31, 2013 and 2012, consisted of the following:

	2013	2012
Deferred Tax Assets:		
Allowance for loan losses due to tax limitations	\$ 688,000	\$ 528,000
Organization costs	438,000	493,000
Share-based compensation	293,000	286,000
Unrealized losses on available-for-sale investment securities reported in net income	181,000	181,000
Net operating losses	1,339,000	1,594,000
Acquisition accounting adjustments	222,000	356,000
Other	553,000	396,000
Total Deferred Tax Assets	3,714,000	3,834,000
Deferred Tax Liabilities:		
Unrealized losses on available-for-sale investment securities reported in other comprehensive income	639,000	679,000
Cash basis reporting for income tax purposes	137,000	147,000
Total Deferred Tax Liabilities	776,000	826,000
Net Deferred Tax Assets	\$ 2,938,000	\$ 3,008,000

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 percent 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, 2013 and 2012, will be fully realized and therefore no valuation allowance was recorded.

At December 31, 2013, the Company had Federal and State net operating loss carryforwards (NOLs) of approximately \$3,882,000 and \$3,831,000, respectively. The Federal and State NOLs begin to expire in 2028 and 2018, respectively.

The Company 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 2010 to 2012 and 2009 to 2012, respectively, are currently open for examination. The total amount of unrecognized tax benefits, including interest and penalties, at December 31, 2013, was not material. The amount of tax benefits that would impact the effective rate, if recognized, is not expected to be material. The Company does not anticipate any significant changes with respect to unrecognized tax benefits within the next 12 months.

ALTAPACIFIC BANCORP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

NOTE 10 - BORROWINGS

The Company has unsecured Federal funds lines of credit with three of its correspondent banks under which it can borrow up to \$16,000,000. There were no borrowings outstanding under these arrangements at December 31, 2013 and 2012.

The Company has a borrowing arrangement with the Federal Home Loan Bank of San Francisco under which it may borrow an amount not to exceed 20 percent of total assets. Various loans totaling approximately \$76,564,000 were pledged to secure FHLB borrowings as of December 31, 2013. In addition, investment securities with amortized costs of \$26,261,000 and estimated fair values of \$26,304,000 were pledged to secure the borrowing arrangement as of December 31, 2013. The total borrowing capacity under these arrangements was \$47,694,000 at December 31, 2013. Various loans totaling approximately \$70,746,000 were pledged to secure FHLB borrowings as of December 31, 2012. In addition, investment securities with amortized cost totaling \$39,377,000 and estimated fair values of \$39,378,000 were pledged to secure the borrowing arrangement as of December 31, 2012. The total borrowing capacity under these arrangements was \$39,414,000 at December 31, 2012.

Advances under these arrangements were at fixed interest rates and consisted of the following at December 31, 2013 and 2012:

Borrowings	Balance at December 31,					
	2013			2012		
	Amount	Average Balance	Weighted Average Rate	Amount	Average Balance	Weighted Average Rate
Short-term	\$ 10,000,000	\$ 5,841,000	1.12%	\$ -	\$ 2,643,000	0.24%
Long-term	10,000,000	1,260,000	0.50%	5,000,000	5,000,000	1.28%
	\$ 20,000,000	\$ 7,101,000	1.01%	\$ 5,000,000	\$ 7,643,000	0.92%

NOTE 11 - COMMITMENTS AND CONTINGENCIES

Operating Leases

The Company leases certain buildings used for branch offices and administrative facilities under long-term, non-cancelable lease agreements, which have been accounted for as operating leases. Such lease agreements expire between 2014 and 2019, and contain renewal options for periods of five years.

ALTAPACIFIC BANCORP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

NOTE 11 - COMMITMENTS AND CONTINGENCIES (CONTINUED)

Operating Leases, (Continued)

Future minimum lease payments are as follows:

<u>December 31,</u>	<u>Amount</u>
2014	\$ 516,000
2015	532,000
2016	338,000
2017	137,000
2018	138,000
Thereafter	<u>34,000</u>
Total	<u>\$ 1,695,000</u>

Rental expense included in occupancy and equipment expense totaled \$529,000 and \$486,000 for the years ended December 31, 2013 and 2012, respectively. Management intends to exercise the renewal options described above and expects additional future minimum lease payments as a result of exercising the renewal options will be approximately \$207,000 in 2016, \$414,000 in 2017, \$414,000 in 2018, and \$2,593,000 thereafter.

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 the following at December 31, 2013 and 2012, respectively:

	<u>2013</u>	<u>2012</u>
Financial instruments whose contract amounts represent credit risks:		
Commitments to extend credit	\$ 49,697,000	\$ 40,013,000
Standby letters of credit	<u>2,081,000</u>	<u>325,000</u>
	<u>\$ 51,778,000</u>	<u>\$ 40,338,000</u>

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.

ALTAPACIFIC BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

NOTE 11 - COMMITMENTS AND CONTINGENCIES (CONTINUED)

Financial Instruments With Off-Balance Sheet Risk, (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. 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, 2013, commercial loan commitments represent approximately 33 percent 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 59 percent of total commitments and are generally secured by property with a loan-to-value ratio not to exceed 80 percent. The majority of real estate commitments also have variable interest rates. Home equity lines of credit represent nine percent 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 the counties of Sonoma, Marin, San Francisco, San Bernardino, and Los Angeles. 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, 2013 and 2012.

In management's judgment, a concentration of loans exists in real estate related loans with approximately 87 percent 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 collectability, 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 collectability of these loans. Personal and business income represents the primary source of repayment for a majority of these loans

Correspondent Companying Agreements

The Company maintains funds on deposit with other federally insured financial institutions under correspondent banking agreements. Through December 31, 2012, all noninterest-bearing transaction accounts were fully guaranteed by the FDIC for the entire amount in the account. Coverage through December 31, 2012, on certain transaction accounts was in addition to the coverage of \$250,000 per depositor available under the FDIC's general deposit insurance rules.

ALTAPACIFIC BANCORP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

NOTE 12 - RELATED PARTY TRANSACTIONS

As of December 31, 2013 and 2012, the Company's balance sheet included deposits from executive officers and directors and their related companies totaling \$8,242,000 and \$7,893,000, respectively, and loans to executive officers and directors and their related companies, which are detailed below:

	December 31,	
	2013	2012
Outstanding balance, beginning of year	\$ 25,000	\$ -
Credit granted, including renewals	825,000	34,000
Repayments	(728,000)	(9,000)
Outstanding balance, end of year	<u>\$ 122,000</u>	<u>\$ 25,000</u>
Undisbursed commitments at end of year	<u>\$ 1,558,000</u>	<u>\$ 1,658,000</u>

In management's opinion, the terms and conditions associated with these arrangements are comparable to those of transactions with unaffiliated parties.

NOTE 13 - SHARE-BASED COMPENSATION

Stock Option Awards

A summary of option activity under the Plan for the years ended December 31, 2013, is presented below:

	2013		Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
	Options	Exercise Price		
Balance, beginning of year	675,084	\$ 7.74		
Granted	3,531	6.37		
Forfeited or expired	(9,812)	7.78		
Balance, end of year	<u>668,803</u>	<u>7.74</u>	<u>3.40 Years</u>	<u>\$ 609,000</u>
Options exercisable	<u>617,478</u>	<u>\$ 7.77</u>	<u>3.40 Years</u>	<u>\$ 66,000</u>
Options available for granting	<u>384,128</u>			

ALTAPACIFIC BANCORP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

NOTE 13 - SHARE-BASED COMPENSATION (CONTINUED)

Stock Option Awards (Continued)

A summary of option activity under the Plan for the years ended December 31, 2012, is presented below:

	2012		Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
	Options	Exercise Price		
Balance, beginning of year	627,042	\$ 7.70		
Granted	56,145	7.75		
Forfeited or expired	(8,103)	7.75		
Balance, end of year	<u>675,084</u>	<u>\$ 7.74</u>	<u>4.40 Years</u>	<u>\$ -</u>
Options exercisable	<u>600,554</u>	<u>\$ 7.78</u>	<u>4.40 Years</u>	<u>\$ -</u>

As of December 31, 2013, the unrecognized share-based compensation expense related to non-vested stock option awards totaled \$169,000. That cost is expected to be amortized on a straight-line basis over a weighted average period of 2.8 years and will be adjusted for subsequent changes in estimated forfeitures. Total compensation cost included in operating expenses was \$77,000 and \$83,000 for the years ended December 31, 2013 and 2012, respectively. The weighted-average grant date fair value of options vested during the year was \$79,000 and \$49,000 for the years ended December 31, 2013 and 2012, respectively.

The following stock option information is for the year ended December 31:

	2013	2012
Dividend yield	0.00%	0.00%
Expected life	6.50 Years	6.50 Years
Expected volatility	51.34%	52.95%
Risk-free interest rate	0.92%	0.84%
Weighted-average grant date fair value	\$3.36	\$4.21

ALTAPACIFIC BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

NOTE 14 - 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. As of December 31, 2013, the maximum amount available for dividend distribution under this restriction was approximately \$1,154,000.

Stock Dividends

On January 31, 2013, the Board of Directors declared a five percent stock dividend which was payable on March 1, 2013. On January 27, 2014, the Board of Directors declared a five percent stock dividend which was payable on February 28, 2014. These stock dividends were accounted for in a manner similar to a stock split because the Company has an accumulated deficit. All share and per share amounts have been restated to give retroactive effect to these five percent stock dividends.

NOTE 15 - BENEFIT PLANS

Salary Continuation Agreements and Officer Supplemental Life Insurance Plans

The Company has entered into salary continuation agreements with certain officers. The plans provide for annual benefits for up to fifteen years after retirement or death. The benefit obligation under these plans totaled \$351,000 and \$50,000, and was fully accrued for the years ended December 31, 2013 and 2012, respectively. The expense recognized under these arrangements totaled \$301,000, and \$50,000 for the years ended December 31, 2013 and 2012, respectively. Certain officers of the Company have supplemental life insurance policies with death benefits available to the officers' beneficiaries.

In connection with these plans, the Company has purchased, single premium life insurance policies with cash surrender values totaling \$6,916,000 and \$5,208,000 at December 31, 2013 and 2012, respectively.

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 three 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 four percent 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 percent vested. Company profit-sharing contributions and related earnings vest 20 percent a year, with 100 percent vesting after five years of service. The Company's expense for matching contributions was \$111,000 and \$99,000 for the years ended December 31, 2013 and 2012, respectively. The Company did not make a discretionary profit-sharing contribution for the years ended December 31, 2013 or 2012.

ALTAPACIFIC BANCORP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

NOTE 16 - OTHER EXPENSES

Other expenses for the years ended December 31 consists of the following:

	<u>2013</u>	<u>2012</u>
Data processing	\$ 474,000	\$ 484,000
Professional fees	268,000	412,000
OREO	22,000	240,000
Amortization of Core Deposit Intangible	171,000	183,000
Regulatory assessments	153,000	158,000
Other	728,000	612,000
	<u>\$ 1,816,000</u>	<u>\$ 2,089,000</u>

NOTE 17 - FAIR VALUE OF FINANCIAL INSTRUMENTS

The estimated carrying fair values of the Company's financial instruments at December 31, 2013, are as follows:

	<u>December 31, 2013</u>		<u>Fair Value Measurements at December 31, 2013 Using:</u>		
	<u>Carrying Amount</u>	<u>Fair Value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Assets					
Cash and due from banks	\$ 6,079,000	\$ 6,079,000	\$ 6,079,000	\$ -	\$ -
Available-for-sale investment securities	74,872,000	74,872,000	-	74,872,000	-
Loans, net	141,162,000	144,326,000	-	-	144,326,000
Federal Reserve Bank stock	1,319,000	1,319,000	-	1,319,000	-
Federal Home Loan Bank stock	1,104,000	1,104,000	-	1,104,000	-
Accrued interest	953,000	953,000	953,000	-	-
Liabilities					
Deposits	\$ 168,995,000	\$ 168,885,000	\$ 152,276,000	\$16,609,000	\$ -
Other borrowings	20,000,000	20,000,000	20,000,000	-	-
Accrued interest	67,000	67,000	67,000	-	-

ALTAPACIFIC BANCORP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

NOTE 17 - FAIR VALUE OF FINANCIAL INSTRUMENTS, (CONTINUED)

The estimated carrying fair values of the Company's financial instruments at December 31, 2012, are as follows:

	December 31, 2012		Fair Value Measurements at December 31, 2012 Using:		
	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
Assets					
Cash and due from banks	\$ 3,135,000	\$ 3,135,000	\$ 3,135,000	\$ -	\$ -
Federal funds sold	18,670,000	18,670,000	18,670,000	-	-
Available-for-sale investment securities	81,408,000	81,408,000	-	81,408,000	-
Loans, net	97,172,000	97,629,000	-	-	97,629,000
Federal Reserve Bank stock	1,362,000	1,362,000	-	1,362,000	-
Federal Home Loan Bank stock	1,026,000	1,026,000	-	1,026,000	-
Accrued interest	828,000	828,000	828,000	-	-
Liabilities					
Deposits	\$ 161,940,000	\$ 161,870,000	\$ 145,261,000	\$16,609,000	\$ -
Other borrowings	5,000,000	5,000,000	5,000,000	-	-
Accrued interest	68,000	68,000	68,000	-	-

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 significant financial instruments:

Financial Assets

The carrying amounts of cash, short-term investments, due from customers on acceptance and Bank acceptances outstanding are considered to approximate fair value. Short-term investments include federal funds sold, securities purchased under agreements to resell, and interest-bearing deposits with banks. The determination of the fair value of investment securities is discussed below. The fair value of loans are estimated using a combination of techniques, including discounting estimated future cash flows and quoted market prices of similar instruments where available.

ALTAPACIFIC BANCORP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

NOTE 17 - FAIR VALUE OF FINANCIAL INSTRUMENTS, (CONTINUED)

Financial Liabilities

The carrying amounts of deposit liabilities payable on demand, and other borrowed funds are considered to approximate fair value. For fixed maturity deposits, fair value is estimated by discounting estimated future cash flows using currently offered rates for deposits of similar remaining maturities. The fair value of long-term debt is based on rates currently available to the Bank for debt with similar terms and remaining maturities.

Off-Balance Sheet Financial Instruments

The fair value of commitments to extend credit and standby letters of credit is estimated using the fees currently charged to enter into similar agreements. The fair value of these financial instruments is not material.

NOTE 18 - FAIR VALUE MEASUREMENTS

The following description of valuation methodologies used for assets recorded at fair value:

Securities

The fair values of securities available for sale are determined by obtaining quoted 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 resulting in a Level 2 classification.

Collateral-Dependent Impaired Loans

The Company does not record loans at fair value on a recurring basis. However, from time to time, fair value adjustments are recorded on these loans to reflect (1) partial write-downs, through charge-offs or specific reserve allowances, that are based on the current appraised or market-quoted value of the underlying collateral. The fair value estimated for collateral-dependent impaired loans are generally based on recent real estate appraisals or broker opinions, obtained from independent third parties, which are frequently adjusted by management to reflect current conditions (Level 3).

Other Real Estate Owned

Other real estate owned represents real estate that has been foreclosed and adjusted to fair value, less selling costs. At the time of foreclosure, these assets are recorded at fair value less costs to sell, which becomes the asset's new basis. Any write-downs based on the asset's fair value at the date of foreclosure are charged to the allowance for loan losses. The fair value of other real estate owned is generally based on recent real estate appraisals or broker opinions, obtained from independent third parties, which are frequently adjusted by management to reflect current conditions and estimated selling costs (Level 2).

ALTAPACIFIC BANCORP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

NOTE 18 - FAIR VALUE MEASUREMENTS (CONTINUED)

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:

<u>December 31, 2013</u>	<u>Fair Value Measurements</u>			
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
Assets Measured at Fair Value on a Recurring Basis				
Assets:				
Securities available-for-sale	\$ -	\$ 74,872,000	\$ -	
Assets Measured at Fair Value on a Non-Recurring Basis				
Collateral-Dependent Impaired Loans, Net of Specific Reserves:				<u>Total Losses</u>
Real estate - commercial	\$ -	\$ -	\$ 669,000	\$ -
Other real estate owned	-	591,000	-	-
<u>December 31, 2012</u>				
Assets Measured at Fair Value on a Recurring Basis				
Assets:				
Securities available-for-sale	\$ -	\$ 81,408,000	\$ -	
Assets Measured at Fair Value on a Non-Recurring Basis				
Collateral-Dependent Impaired Loans, Net of Specific Reserves:				<u>Total Losses</u>
Real estate - commercial	\$ -	\$ -	\$ 718,000	\$ -
Other real estate owned	-	591,000	-	175,000

As of December 31, 2013, collateral-dependent impaired loans, which are measured for impairment using the fair value of the collateral, had a carrying value of approximately \$909,000, with a specific reserve of \$240,000.

Losses recognized for write-down of other real estate owned for the years ended December 31, 2013 and 2012 totaled \$-0- and \$175,000, respectively.

The Company had no liabilities measured at fair value on a recurring or non-recurring basis at December 31, 2013 and 2012.

ALTAPACIFIC BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

NOTE 19 - MINIMUM REGULATORY CAPITAL REQUIREMENTS

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 capital guidelines described below apply on a consolidated basis to bank holding companies with consolidated assets of \$500 million or more. For bank holding companies with less than \$500 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 neither (a) nor (b) apply to the Company, regulators look to the Bank's capital ratios when assessing the adequacy of the Company's capital.

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 below. 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 Company and Bank met all of their capital adequacy requirements as of December 31, 2013 and 2012.

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 ratios of total and Tier 1 capital to risk-weighted assets and Tier 1 capital to average assets as set forth in the table on the following page. The most recent notification from the FRB 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.

ALTAPACIFIC BANCORP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

NOTE 19 - MINIMUM REGULATORY CAPITAL REQUIREMENTS (CONTINUED)

The Bank's actual capital amounts and notations of December 31, 2013 and 2012 are as follows:

	Actual		For Capital Adequacy Purposes		To Be Well-Capitalized Under Prompt Corrective Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2013						
Total capital (to risk-weighted assets)	\$ 47,280,000	22.2%	\$ 17,071,000	8.0%	\$ 21,339,000	10.0%
Tier 1 capital (to risk-weighted assets)	45,153,000	21.2%	8,535,000	4.0%	12,803,000	6.0%
Tier 1 capital (to average assets)	45,153,000	18.6%	9,717,000	4.0%	12,147,000	5.0%
As of December 31, 2012						
Total capital (to risk-weighted assets)	\$ 44,283,000	26.9%	\$ 17,843,000	8.0%	\$ 22,303,000	10.0%
Tier 1 capital (to risk-weighted assets)	42,583,000	25.9%	6,574,000	4.0%	9,861,000	6.0%
Tier 1 capital (to average assets)	42,583,000	19.1%	8,921,000	4.0%	11,152,000	5.0%

NOTE 20 - SUBSEQUENT EVENT

On January 31, 2014 the Company announced the signing of a definitive agreement to merge with Mission Oaks Bancorp. Under the terms of the agreement AltaPacific Bancorp will acquire Mission Oaks Bancorp for \$0.30 per share in an all-cash transaction valued at approximately \$3.5 million. The operations of Mission Oaks National Bank will be combined into AltaPacific Bank. Completion of the merger is subject to regulatory and Mission Oaks Bancorp's shareholders' approval as well as other customary closing conditions, and the amount of cash consideration per share are subject to potential adjustment. The transaction is expected to be completed in the second quarter of 2014. Mission Oaks National Bank operates two branches in Temecula and Fallbrook, California. At the completion of the merger, the Mission Oaks National Bank branches will be operated as branches of AltaPacific Bank.

