

MISSION  
VALLEY  
BANCORP



FINANCIAL  
STATEMENTS  
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**REPORT OF INDEPENDENT AUDITORS**

The Board Directors and Shareholders of  
Mission Valley Bancorp

We have audited the accompanying consolidated financial statements of Mission Valley Bancorp and its subsidiary, which comprise the consolidated statements of financial condition as of December 31, 2012 and 2011, the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

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

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

**Auditor's Responsibility**

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

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

We believe that the audit evidence 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 Mission Valley Bancorp and its subsidiary as of December 31, 2012 and 2011, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.



Los Angeles, California  
March 15, 2013

See accompanying notes.



**MISSION VALLEY BANCORP**  
**CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION**  
**DECEMBER 31, 2012 AND 2011**  
(Dollars in thousands, except share data)

	<u>2012</u>	<u>2011</u>
<b>ASSETS</b>		
Cash and due from banks	\$ 8,476	\$ 10,213
Federal funds sold	12,445	21,730
Total cash and cash equivalents	20,921	31,943
Interest bearing deposits in other banks	8,290	11,179
Investment securities:		
Available for sale, at fair value	22,986	15,766
Held to maturity, at amortized cost	5,550	6,604
Loans, net	171,766	169,467
Loans held for sale	720	-
Premises and equipment, net	503	838
Other real estate owned ("OREO")	192	-
Deferred tax asset, net	693	925
Bank owned life insurance	5,775	5,579
Restricted equity securities	1,557	1,843
Accrued interest receivable	680	782
Other assets	2,143	1,659
<b>TOTAL ASSETS</b>	<b>\$ 241,776</b>	<b>\$ 246,585</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Liabilities</b>		
Deposits:		
Non-interest bearing demand	\$ 75,749	\$ 68,506
Interest-bearing demand	52,674	38,863
Savings, NOW, exchange and escrow	11,897	9,875
Time deposits under \$100,000	5,802	7,496
Time deposits \$100,000 and over	52,340	62,991
Total deposits	198,462	187,731
Borrowings	5,000	21,000
Junior subordinated deferrable interest debentures	6,186	6,186
Accrued interest payable and other liabilities	1,863	2,004
<b>Total liabilities</b>	<b>211,511</b>	<b>216,921</b>
Commitments and contingencies - Note 11		
<b>Shareholders' Equity</b>		
Preferred stock - 10,000,000 shares authorized; 468,336 shares issued and outstanding at December 31, 2012 and 2011		
Series B, designated	4,580	4,580
Series C, designated	5,500	5,500
Series D, designated	4,836	4,836
Common stock - 10,000,000 shares authorized; no par value; 2,631,233 and 2,615,388 shares issued and outstanding at December 31, 2012 and 2011, respectively	9,917	9,917
Additional paid in capital	191	149
Retained earnings	5,075	4,490
Accumulated other comprehensive income	166	192
<b>Total shareholders' equity</b>	<b>30,265</b>	<b>29,664</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<b>\$ 241,776</b>	<b>\$ 246,585</b>

See accompanying notes.

**MISSION VALLEY BANCORP**  
**CONSOLIDATED STATEMENTS OF INCOME**  
**FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011**  
(Dollars in thousands, except per share data)

	<u>2012</u>	<u>2011</u>
<b>INTEREST INCOME</b>		
Interest and fees on loans	\$ 11,668	\$ 12,339
Interest on investment securities	487	568
Other interest income	209	156
Total interest income	<u>12,364</u>	<u>13,063</u>
<b>INTEREST EXPENSE</b>		
Interest on deposits	972	1,362
Interest on borrowings	322	462
Total interest expense	<u>1,294</u>	<u>1,824</u>
<b>NET INTEREST INCOME</b>	11,070	11,239
<b>PROVISION FOR LOAN LOSSES</b>	<u>1,302</u>	<u>1,331</u>
<b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>	<u>9,768</u>	<u>9,908</u>
<b>NON-INTEREST INCOME</b>		
Service charges and other income	1,819	1,828
Gain on sale of loans	578	-
Net merchant income	162	54
Net realized gains on the sale of securities	54	-
Increase in cash surrender value of bank owned life insurance	196	194
Other income	417	736
Total non-interest income	<u>3,226</u>	<u>2,812</u>
<b>NON-INTEREST EXPENSES</b>		
Salaries, wages and employee benefits	6,093	5,899
Occupancy and equipment expenses	804	702
Furniture and equipment	1,042	986
Data processing	776	871
Advertising	205	218
Legal, professional, and consulting	891	730
Insurance	254	490
Other operating expenses	1,221	1,049
Total non-interest expenses	<u>11,286</u>	<u>10,945</u>
<b>NET INCOME BEFORE PROVISION FOR INCOME TAXES</b>	1,708	1,775
Provision for income taxes	642	621
<b>NET INCOME</b>	<u>\$ 1,066</u>	<u>\$ 1,154</u>
<b>Earnings per share available to common shareholders - basic</b>	<u>\$ 0.22</u>	<u>\$ 0.26</u>
<b>Earnings per share available to common shareholders - diluted</b>	<u>\$ 0.22</u>	<u>\$ 0.26</u>

See accompanying notes.

**MISSION VALLEY BANCORP**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
**FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011**  
(Dollars in thousands)

	<u>2012</u>	<u>2011</u>
Net income	\$ 1,066	\$ 1,154
Other comprehensive income (loss):		
Change in unrealized gains on available for sale securities, net of taxes of \$4 in 2012 and 2011	5	6
Reclassification adjustment for net gains included in net income, net of taxes of \$23 in 2012	<u>(31)</u>	<u>-</u>
Other comprehensive income (loss)	<u>(26)</u>	<u>6</u>
<b>Total comprehensive income</b>	<u>\$ 1,040</u>	<u>\$ 1,160</u>

See accompanying notes.

**MISSION VALLEY BANCORP**  
**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**  
**FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011**  
(Dollars in thousands, except share data)

	Preferred Stock		Common Stock	
	Number of Shares	Amount	Number of Shares	Amount
<b>BALANCE, December 31, 2010</b>	468,336	\$ 14,916	2,543,293	\$ 9,717
Stock options exercised	-	-	56,250	200
Share-based compensation	-	-	15,845	-
Dividends on preferred stock	-	-	-	-
Total comprehensive income	-	-	-	-
<b>BALANCE, December 31, 2011</b>	468,336	14,916	2,615,388	9,917
Share-based compensation	-	-	15,845	-
Dividends on preferred stock	-	-	-	-
Total comprehensive income	-	-	-	-
<b>BALANCE, December 31, 2012</b>	468,336	\$ 14,916	2,631,233	\$ 9,917

**MISSION VALLEY BANCORP**  
**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**  
**FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011**  
(Dollars in thousands, except share data)

Additional Paid in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Shareholders' Equity
\$ 60	\$ 3,817	\$ 186	\$ 28,696
-	-	-	200
89	-	-	89
-	(481)	-	(481)
-	1,154	6	1,160
\$ 149	4,490	192	29,664
42	-	-	42
-	(481)	-	(481)
-	1,066	(26)	1,040
\$ 191	\$ 5,075	\$ 166	\$ 30,265

See accompanying notes.

See accompanying notes.

**MISSION VALLEY BANCORP**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011**  
(Dollars in thousands)

	2012	2011
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$ 1,066	\$ 1,154
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of premises and equipment	431	437
Provision for loan losses	1,302	1,331
Amortization of deferred loan fees and costs, net	380	219
Gain on sale of securities available for sale	(54)	-
Origination of loans held for sale	(5,847)	-
Proceeds from sale of loans held for sale	5,705	-
Gain on sale of loans held for sale	(578)	-
Gain on sale of OREO	-	(85)
Accretion and amortization on investments	(412)	42
Share-based compensation	42	89
Deferred taxes	251	406
Increase in cash surrender value of bank owned life insurance	(196)	(194)
Net change in:		
Accrued interest receivable and other assets	(382)	174
Accrued interest payable and other liabilities	(141)	482
Net cash provided by operating activities	<u>1,567</u>	<u>4,055</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Changes in interest bearing deposits in other banks, net	2,889	(2,515)
Purchases of available-for-sale investments	(15,943)	(4,000)
Purchases of held-to-maturity investments	-	(9,464)
Proceeds from repayments, sales, and maturities of available-for-sale investments	9,153	10,550
Proceeds from prepayments and maturities of held-to-maturity investments	1,045	2,876
Proceeds from sale of restricted equity securities	286	252
Proceeds from sale of OREO	-	1,264
Net change in loans	(4,173)	14,071
Purchases of premises and equipment	(96)	(16)
Net cash (used in) provided by investing activities	<u>(6,839)</u>	<u>13,018</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Net decrease in time deposits	(12,345)	(16,115)
Net increase in other deposits	23,076	10,086
Repayment of FHLB advances	(16,000)	(5,000)
Exercise of stock options	-	200
Dividends paid on preferred stock	(481)	(481)
Net cash used in financing activities	<u>(5,750)</u>	<u>(11,310)</u>
<b>Change in Cash and Cash Equivalents</b>	(11,022)	5,763
Cash and cash equivalents, beginning of year	31,943	26,180
Cash and cash equivalents, end of year	<u>\$ 20,921</u>	<u>\$ 31,943</u>
<b>Supplemental Disclosures of Cash Flow Information</b>		
Interest paid	\$ 1,319	\$ 1,892
Taxes paid	789	70
<b>Supplemental Disclosures of Noncash Investing and Financing Activities</b>		
Transfers from loans to other real estate owned	\$ 192	\$ 906
Change in unrealized gain on investments available for sale	(45)	10

See accompanying notes.

**MISSION VALLEY BANCORP**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 1 - Summary of Significant Accounting Policies**

**Nature of operations** - Mission Valley Bank (the "Bank") was formed during 2001 and on May 24, 2005, the shareholders of the Bank approved the exchange of common stock in Mission Valley Bank for common stock of a newly formed holding company, Mission Valley Bancorp (the "Company"). The transaction was consummated on August 20, 2005. The Bank is the Company's only subsidiary and it is wholly owned by the Company. The Company provides a full range of banking services to individual and corporate customers through the Bank. The Bank has three branches located in Sun Valley, Valencia and Santa Clarita, California. The Company has been authorized by the Federal Reserve Bank of San Francisco to engage in lending activities separate from the Bank, but to date has not done so.

Mission Valley Bank is a state chartered depository institution subject to regulation and examination by the California Department of Financial Institutions ("DFI") and Federal Deposit Insurance Corporation ("FDIC").

**Basis of presentation and consolidation** - The accompanying consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") and general practices within the banking industry. The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, Mission Valley Bank. All significant intercompany balances and transactions have been eliminated in consolidation.

In 2005, the Company issued \$6,186,000 of junior subordinated deferrable interest debentures through Mission Valley Statutory Trust I. The Company follows generally accepted accounting principles that determines when variable interest entities should be consolidated and determined that the Mission Valley Statutory Trust I should not be consolidated. As a result, the consolidated statements of financial condition include \$6,186,000 as junior subordinated deferrable interest debentures. Also included in other assets in the consolidated statements of financial condition is \$186,000 of investments in Mission Valley Statutory Trust I, which is reported using the cost method.

**Subsequent events** - The Company recognizes in the consolidated financial statements the effect of all subsequent events (transactions or events that occur after the balance sheet date but before the consolidated financial statements are issued) that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing the consolidated financial statements. The Company's consolidated financial statements do not recognize subsequent events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after the balance sheet date and before consolidated financial statements are available to be issued. The Company has evaluated subsequent events through March 15, 2013, which is the date the consolidated financial statements were available to be issued. There were no subsequent events that required disclosure in the consolidated financial statements.

**Use of estimates** - The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent

**MISSION VALLEY BANCORP**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

assets and liabilities at the date of the consolidated statements of financial condition and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, valuation of investment securities, valuation of deferred tax assets and share-based compensation.

**Concentrations of credit risk** - Assets and liabilities that subject the Company to concentrations of credit risk consist of interest-bearing deposits at other banks, investments available-for-sale, loans and deposits. Most of the Company's customers are located within Los Angeles County and surrounding areas. For the years ended December 31, 2012 and 2011, the Company did not have any significant concentrations in its business with any one customer.

As of December 31, 2012 and 2011, the Company has cash deposits at other financial institutions in excess of the FDIC insured limits. The Company places these deposits with major financial institutions and monitors the financial condition of these institutions. Management believes the risk of loss associated with such deposits to be minimal.

The Company's loan portfolio consists primarily of loans to borrowers within Southern California. Although the Company has a diversified loan portfolio, a substantial part of the debtors' ability to honor their contracts is dependent upon the economic conditions in this region. Real estate secured loans represented approximately 53% of total gross loans at December 31, 2012 and 2011. Management has taken this factor into account in the determination of the allowance for loan losses.

**Cash and cash equivalents** - For purposes of reporting cash and cash equivalents in the consolidated statements of financial condition and the consolidated statements of cash flows, cash and cash equivalents include cash, due from banks and federal funds sold, all of which mature within ninety days.

Banking regulations require that banks maintain a percentage of their deposits as reserves in cash or on deposit with the Federal Reserve Bank. The Company was in compliance with its reserve requirements as of December 31, 2012 and 2011.

**Interest bearing deposits in other banks** - Interest-bearing deposits in other banks are purchased with an original maturity date greater than ninety days and are carried at amortized cost. Interest-bearing deposits in other banks include certificates of deposits in major financial institutions located throughout the United States of America.

**Investment securities** - In accordance with generally accepted accounting principles, the Company is required to designate its readily marketable investments securities as "held-to-maturity", "available-for-sale", or "trading". The Company did not designate any of its investments as trading securities. Debt securities are classified as held to maturity if the Company has both the intent and ability to hold those securities to maturity regardless of changes in market conditions, liquidity needs or changes in general

**MISSION VALLEY BANCORP**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

economic conditions. These securities are carried at cost adjusted for amortization of premium and accretion of discount, computed by the effective interest method over their contractual lives. Debt securities classified as available-for-sale are reported at fair value, with unrealized gains and losses excluded from earnings and reported as a separate component of shareholders' equity as an item of other comprehensive income. Investment transactions are recorded on the trade date. Gains and losses realized on disposition of investment securities are recognized at the time of sale based upon the specific identification method. Premiums and discounts are recognized in interest income using the interest method over the period to maturity.

Interest income from the investment securities portfolio is accrued as earned including the accretion of discounts and the amortization of premiums based on the original cost of each security owned. Discounts and premiums are accreted and amortized on a method that approximates the effective interest method to the maturity date of the security with the exception of the mortgage backed securities. Discounts and premiums on mortgage-backed securities are accreted and amortized to the expected maturity date of the investment security. Realized gains or losses on the sale of investment and mortgage-backed securities are reported in the consolidated statement of operations as of the trade date and determined using the amortized cost of the specific security sold. Declines in the fair value of individual securities below their cost that are deemed other than temporary result in write-downs of the individual securities to their fair value. The related write-downs are reported in the consolidated statement of operations as realized losses.

Management performs regular impairment analyses on the securities portfolio in accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") guidance related to the consideration of impairment related to certain debt and equity securities. If it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the debt security not impaired at acquisition, an other-than-temporary impairment is considered to have occurred. When an other-than-temporary impairment ("OTTI") occurs, the cost basis of the security is written down to its fair value (as the new cost basis) and the write-down is accounted for as a realized loss if it is credit related. In assessing whether impairment represents OTTI, the Company must consider whether it intends to sell a security or if it is likely that they would be required to sell the security before recovery of the amortized cost basis of the investment, which may be maturity. For debt securities, if the Company intends to sell the security or it is likely that a sale of the security may be required before recovering the cost basis, the entire impairment loss would be charged to results of operations as an OTTI. If the Company does not intend to sell the security and it is not likely the sale of the security is required by the Company, and the Company does not expect to recover the entire amortized cost basis of the security, only the portion of the impairment loss representing credit losses would be charged to results of operations. The credit loss on a security is measured as the difference between the amortized cost basis and the present value of the cash flows to be expected to be collected. Projected cash flows are discounted by the original or current effective interest rate depending on the nature of the security being measured for potential OTTI. The remaining impairment related to other factors, the difference

**MISSION VALLEY BANCORP**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

between the present value of the cash flows to be expected to be collected and fair value, is recognized as a charge to other comprehensive income ("OCI").

**Loans** - Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at their outstanding unpaid principal balances reduced by any charge-offs or specific valuation amounts and net of any deferred fees or costs on originated loans, or unamortized premiums or discounts on purchased loans. Interest income on loans is calculated by the simple-interest method on daily balances of the principal amount outstanding. Loan origination fees and origination costs are capitalized and recognized as an adjustment to yield over the life of the related loan using the effective interest method. The accrual of interest on loans is discontinued at the time the loan becomes ninety-days delinquent unless the credit is well secured and in process of collection. In some cases, loans can be placed on nonaccrual status or charged-off at an earlier date if collection of principal or interest is considered doubtful. Subsequent collections of interest are applied to unpaid balances or included in interest income based upon management's assessment of the likelihood that principal will be collected.

When loans are placed on nonaccrual status, all interest previously accrued but not collected is reversed against current period interest income. Income on nonaccrual loans is subsequently recognized only to the extent that cash is received and the loan's principal balance is deemed collectible. Interest accruals are resumed on such loans only when they are brought current with respect to interest and principal and when, in the judgment of management, the loans are estimated to be fully collectible as to all principal and interest.

A loan is considered impaired when it is probable that the Company will not be able to collect all principal and interest amounts due according to the loan's contractual terms based upon available information and events. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. The amount of the valuation allowance for impaired loans is determined by comparing the recorded investment in each loan with its value measured by one of three methods: (i) the estimated present value of total expected future cash flows, discounted at the loan's effective interest rate; (ii) the loan's observable market price, if available from a secondary market; or (iii) by the fair value of the underlying collateral if the loan is collateral dependent.

If the measure of impairment for an impaired loan is less than the related recorded investment, a specific valuation allowance (impairment allowance) is established as a component of the allowance for loan losses through a charge to the provision for loan losses. Subsequent permitted adjustments to the impairment allowance are made through a corresponding charge or credit to the provision for loan losses.

Loans are reported as restructured when the Company grants concession(s) to a borrower experiencing financial difficulties that it would not otherwise consider. Examples of such concession include

**MISSION VALLEY BANCORP**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

forgiveness of principal or accrued interest, extending the maturity date(s), or providing a lower interest rate than would be normally available for a transaction of similar risk. As a result of these concessions, restructured loans are impaired as the Company will not collect all amounts due, both principal and interest, in accordance with the terms of the original loan agreement. Impairment allowances on non-collateral dependent restructured loans are measured by comparing the present value of expected future cash flows on the restructured loans discounted at the interest rate of the original loan agreement to the loan's carrying value. These impairment allowances are recognized as a specific component to be provided for in the allowance for loan losses.

**Allowance for loan losses** - The provision for loan losses charged to results of operations is an amount sufficient to bring the allowance for loan losses to an estimated balance considered adequate to absorb probable losses inherent in the portfolio at the date of the consolidated financial statements. 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.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability of the loans that considers historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral, and prevailing economic conditions. The evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. The allowance consists of specific, general, and unallocated components. The specific component relates to loans that are classified as impaired, doubtful, substandard, or special mention. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

**Loans held for sale** - The portions of U.S. Small Business Administration ("SBA") loans that are guaranteed by the SBA are classified by management as loans held for sale since the Company intends to sell these loans subsequent to the balance sheet date. These loans are recorded at the lower of aggregate cost or estimated fair value. The fair value of SBA loans held for sale is based primarily on prices that secondary markets are currently offering for loans with similar characteristics. Net unrealized losses, if any, are recognized through a valuation allowance through a charge to income. The carrying value of SBA loans held for sale is net of premiums as well as deferred origination fees and costs. Premiums and net origination fees and costs are deferred and included in the basis of the loans in calculating gains and losses upon sale. SBA loans are generally secured by the borrowing entities' assets such as accounts receivable, property and equipment, and other business assets. The Company generally recognizes gains or losses on these loan sales based on the difference between the sales proceeds received and the allocated carrying value of the loans sold (which included deferred premiums and net origination fees and costs). The non-guaranteed portion of SBA loans is not typically sold by the



**MISSION VALLEY BANCORP**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

Company and is classified as held for investment. In connection with the Company's SBA lending activities, the Company recognizes servicing assets when servicing rights are retained. The Company initially recognizes and measures at fair value servicing rights obtained from SBA loan sales. The Company subsequently measures these servicing assets by using the amortization method, which amortizes servicing assets in proportion to, and over the period of, estimated net servicing income. The amortization of the servicing assets is analyzed periodically and is adjusted to reflect changes in prepayment rates and other estimates. As the Company only engaged in the sale activities starting 2012, the servicing asset is immaterial to the consolidated financials and is included in other assets on the consolidated statements of financial condition and the related amortization is included in other operating expenses in the consolidated statements of income.

**Premises and equipment** - Premises and equipment are reported at cost less accumulated depreciation and amortization. Depreciation is computed using the straight-line method over the estimated useful lives, which range from three to five years for furniture and equipment. Leasehold improvements are amortized over the shorter of the remaining lease term and the subsequent option period that is likely to be exercised or the estimated useful lives of the leasehold improvements.

Expenditures for betterments or major repairs are capitalized and those for ordinary repairs and maintenance are charged to results of operations as incurred. Gains and losses on dispositions are included in current results of operations.

The Company reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amounts of such assets may not be recoverable. If the sum of the expected future cash flows is less than the stated amount of the asset, an impairment loss is recognized for the difference between the fair value of the asset and its carrying amount.

**Other real estate owned** - Assets acquired in settlement of loans are recorded at fair value less estimated disposal costs. Any excess of the carrying amount of the loan over the fair value of the asset is charged against the allowance for loan losses at the time of transfer. Subsequent to the transfer, any losses on disposition or write-downs as a result of declines in market value of specific assets are charged against current results of operations. Real estate acquired through foreclosure sale, deed-in-lieu of foreclosure, and bank property for which banking use is no longer contemplated are classified as other real estate owned on the consolidated statements of financial position. Operating income and expenses incurred on these properties are reflected in current earnings within non-interest expense.

**Income taxes** - The Company uses the asset and liability method to account for income taxes. The objective of the asset and liability method is to establish deferred tax assets and liabilities for the temporary differences between the financial reporting basis and the income tax basis of the Company's assets and liabilities at enacted tax rates expected to be in effect when such amounts are realized or settled.

**MISSION VALLEY BANCORP**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

The Company's annual tax rate is based on its income, statutory tax rates and tax planning opportunities available in which it operates. Tax laws are complex and subject to different interpretations by the taxpayer and respective governmental taxing authorities. Significant judgment is required in determining tax expense and in evaluating tax positions, including evaluating uncertainties. Accounting for income taxes prescribes a recognition threshold and a measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return.

Benefits from tax positions are recognized in the financial statements only when it is more likely than not that the tax position will be sustained upon examination by the appropriate taxing authority that would have full knowledge of all relevant information. A tax position that meets the more-likely-than-not recognition threshold is measured at the largest amount of benefit that is greater than fifty percent likely of being realized upon ultimate settlement. The Company reviews its tax positions periodically and adjusts the balances as new information becomes available. It is the Company's policy to recognize interest and penalties associated with uncertain tax positions as components of other operating expenses in the statements of operations.

Deferred income tax assets represent amounts available to reduce income taxes payable on taxable income in future years. Such assets arise because of temporary differences between the financial reporting and tax bases of assets and liabilities, as well as from net operating loss and tax credit carry forwards. The Company evaluates the recoverability of these future tax deductions by assessing the adequacy of future expected taxable income from all sources, including reversal of taxable temporary differences, forecasted operating earnings and available tax planning strategies. These sources of income inherently rely heavily on estimates. The Company uses historical experience and short and long-range business forecasts to provide insight. Although realization is not assured for the remaining deferred income tax assets, the Company believes it is more likely than not the deferred tax assets will be fully recoverable within the applicable statutory expiration periods. However, deferred tax assets could be reduced in the near term if estimates of taxable income are significantly reduced or available tax planning strategies are no longer viable.

**Bank owned life insurance** - The Company invests in Bank Owned Life Insurance ("BOLI"). BOLI involves the purchasing of life insurance by the Company on a chosen group of employees. The Company is the owner and beneficiary of these policies. BOLI is recorded as an asset at cash surrender value. Increases in the cash value of these policies, as well as insurance proceeds received, are recorded in other non-interest income and are not subject to income tax.

**Restricted equity securities** - At December 31, 2012 and 2011, the Company held \$1,011,100 and \$1,297,800, respectively, of shares of Federal Home Loan Bank ("FHLB"). The Company evaluates its investment in FHLB stock for impairment on periodic basis. The FHLB has been in compliance with all of its regulatory capital requirements at the end of 2012 and 2011. The Company has not recorded an impairment on its investment of FHLB stock during 2012 and 2011.

**MISSION VALLEY BANCORP**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

The Company also invests in the stock of Pacific Coast Bankers Bank ("PCBB") in connection with its correspondent banking arrangement with PCBB. At December 31, 2012 and 2011, the Company held approximately \$531,000 of PCBB stock. PCBB stock is restricted as to purchase, sale and redemption.

In addition, the Company held \$15,000 of California Economic Development Lending Initiative ("CEDLI") stock at December 31, 2012 and 2011.

The investments in FHLB stock, PCBB stock, and CEDLI stock are carried as cost method investments as of December 31, 2012 and 2011.

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

**Share-based compensation** - The Company accounts for stock option awards whereby the compensation cost relating to share-based payment transactions be recognized in the statements of operations based upon the grant-date fair value of the stock options granted by the Company. The effect of stock-based accounting rules are to require entities to measure the cost of employee services received in exchange for stock options and to recognize the cost over the period the employee is required to provide services for the award. The fair value of stock options are measured using a Black-Sholes pricing model.

The Company's 2006 Stock Option and Restricted Stock Grant Plan provides for granting of restricted stock units for the benefit of certain members of the board of directors, executives and key employees of the Company and its affiliates. Restricted stock unit grants are subject to performance-based vesting as well as other approved vesting conditions. Compensation expense is recognized over the service period to the extent restricted stock units are expected to vest.

**Advertising costs** - Advertising costs of \$205,000 and \$218,000 for the years ended December 31, 2012 and 2011 were expensed as incurred.

**Comprehensive income** - Comprehensive income consists of net income and other comprehensive income (loss). Other comprehensive income (loss) consists of unrealized gains and losses on securities available-for-sale which is also recognized as separate component of consolidated shareholders' equity.

**Common stock** - The Company has authorized 10 million shares of common stock. Each share entitles the holder to one vote. There are no dividend or liquidation preferences, participation rights, call prices or dates, conversion prices or rates, sinking fund requirements, or unusual voting rights associated with these shares.

**MISSION VALLEY BANCORP**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**Earnings per share ("EPS")** - Earnings per share amounts have been computed using both the weighted average number of shares outstanding of common stock for the purposes of computing basic EPS and the weighted average number of shares outstanding of common stock plus dilutive common stock equivalents for the purpose of computing diluted EPS. Basic EPS is computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding for the period. Basic EPS excludes the dilutive effect that could occur if any securities or other contracts to issue common stock were exercised or converted into or resulted in the issuance of common stock. Diluted EPS is computed by dividing net income available to common shareholders by the sum of the weighted average number of common shares outstanding for the period plus the number of additional common shares that would have been outstanding if the potentially dilutive common shares had been issued. The dilutive calculation excludes 10,760 and 20,760 options outstanding for the years ended December 31, 2012 and 2011, respectively, for which the exercise price exceeded the average market price of the Company's common stock during those years. Basic and diluted EPS are calculated as follows:

	<u>2012</u>	<u>2011</u>
<i>(Dollars in thousands, except share and per share data)</i>		
<b>BASIC EARNINGS PER SHARE</b>		
Net income	\$ 1,066	\$ 1,154
Less: Dividends paid on preferred stock	<u>(481)</u>	<u>(481)</u>
Net income available to common shareholders	\$ 585	\$ 673
Divided by: Weighted average common shares outstanding	<u>2,624</u>	<u>2,568</u>
Basic earnings per share available to common shareholders	<u>\$ 0.22</u>	<u>\$ 0.26</u>
<b>DILUTED EARNINGS PER SHARE</b>		
Net income	\$ 1,066	\$ 1,154
Less: Dividends paid on preferred stock	<u>(481)</u>	<u>(481)</u>
Net income available to common shareholders	\$ 585	\$ 673
Weighted average common shares outstanding	2,624	2,568
Add: Dilutive effect of stock options	<u>6</u>	<u>30</u>
Divided by: Weighted average shares outstanding, including potentially dilutive effect of stock options	<u>2,630</u>	<u>2,598</u>
Diluted earnings per share available to common shareholders	<u>\$ 0.22</u>	<u>\$ 0.26</u>

**MISSION VALLEY BANCORP**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**Fair value measurements** - FASB ASC 820, *Fair Value Measurements and Disclosures*, defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. FASB ASC 820 establishes a three-level hierarchy for disclosure of assets and liabilities recorded at fair value. The classification of assets and liabilities within the hierarchy is based on whether the inputs to the valuation methodology used for measurement are observable or unobservable. Observable inputs reflect market-derived or market-based information obtained from independent sources, while unobservable inputs reflect our estimates about market data. In general, fair values determined by Level 1 inputs utilize quoted prices for identical assets or liabilities traded in active markets that the Company has the ability to access. Fair values determined by Level 2 inputs utilize inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar assets and liabilities in active markets, and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals. Level 3 inputs are unobservable inputs for the asset or liability, and include situations where there is little, if any, market activity for the asset or liability. In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability.

**Recently issued accounting pronouncements** - In October 2012, the FASB issued ASU No. 2012-04, *Technical Corrections and Improvements*. This Update provides guidance clarifications and reference corrections throughout the Codification, as well as conform terminology and clarify certain guidance related to fair value. For public entities, the transition guidance will be effective for fiscal periods beginning after December 15, 2012. The Company is currently evaluating this ASU and does not expect it to have a material impact on the consolidated financial statements.

In December 2011, the FASB issued ASU No. 2011-12, *Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in ASU No 2011-05*. The Update supersedes certain paragraphs in ASU No. 2011-05 relating to the presentation of reclassification adjustments. All other requirements in ASU No. 2011-05 are not affected by this Update, including the requirement to report comprehensive income either in a single continuous financial statement or in two separate but consecutive financial statements. This ASU is effective for the Company's annual reporting period beginning after December 15, 2011. The Company elected to early adopt ASU No. 2011-05 for the year ended December 31, 2011 and is applying ASU 2011-12 consistently for the year ended December 31, 2012.

In April 2011, the FASB issued ASU No. 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*. The Update amends existing guidance regarding the highest and best use and valuation premise by clarifying these concepts are only

**MISSION VALLEY BANCORP**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

applicable to measuring the fair value of nonfinancial assets. The Update also clarifies that the fair value measurement of financial assets and financial liabilities which have offsetting market risks or counterparty credit risks that are managed on a portfolio basis, when several criteria are met, can be measured at the net risk position. Additional disclosures about Level 3 fair value measurements are required including a quantitative disclosure of the unobservable inputs and assumptions used in the measurement, a description of the valuation process in place, and discussion of the sensitivity of fair value changes in unobservable inputs and interrelationships about those inputs as well disclosure of the level of the fair value of items that are not measured at fair value in the financial statements but disclosure of fair value is required. The provisions of ASU No. 2011-04 were effective for the Company's annual reporting period beginning after December 15, 2011 and the Company implemented them during 2012.

In April 2011, the FASB issued ASU No. 2011-02, *A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring*. The Update provides additional guidance relating to when creditors should classify loan modifications as troubled debt restructurings. The ASU also ends the deferral issued in January 2011 of the disclosures about troubled debt restructurings required by ASU No. 2010-20. The provisions of ASU No. 2011-02 and the disclosure requirements of ASU No. 2010-20 are effective for the Company's annual period beginning on or after June 15, 2011. The guidance applies retrospectively to restructurings occurring on or after January 1, 2012. Early adoption was permitted. The Company adopted ASU No. 2011-02 during 2011.

**MISSION VALLEY BANCORP**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 2 - Investment Securities**

Investment securities have been classified in the statements of financial condition according to management's intent and ability as available-for-sale or held-to-maturity. The carrying amounts of securities and their estimated fair values at December 31, 2012 and 2011 were as follows:

	<b>December 31, 2012</b>			
	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b>Estimated Fair Value</b>
<i>(Dollars in thousands)</i>				
<b>Available-for-Sale</b>				
Agency securities	\$ 2,000	\$ 3	\$ (1)	\$ 2,002
Mortgage and asset-backed securities	18,315	255	(12)	18,558
Corporate bonds	1,020	5	-	1,025
Municipal investments	570	3	-	573
Mutual fund investments	800	28	-	828
	<u>\$ 22,705</u>	<u>\$ 294</u>	<u>\$ (13)</u>	<u>\$ 22,986</u>
<b>December 31, 2012</b>				
	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b>Estimated Fair Value</b>
<i>(Dollars in thousands)</i>				
<b>Held-to-Maturity</b>				
Mortgage and asset-backed securities	\$ 2,050	\$ 24	\$ -	\$ 2,074
Corporate bonds	3,500	67	-	3,567
	<u>\$ 5,550</u>	<u>\$ 91</u>	<u>\$ -</u>	<u>\$ 5,641</u>

**MISSION VALLEY BANCORP**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

	<b>December 31, 2011</b>			
	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b>Estimated Fair Value</b>
<i>(Dollars in thousands)</i>				
<b>Available-for-Sale</b>				
Mortgage and asset-backed securities	\$ 12,652	\$ 282	\$ -	\$ 12,934
Corporate bonds	1,988	22	-	2,010
Mutual fund investments	800	22	-	822
	<u>\$ 15,440</u>	<u>\$ 326</u>	<u>\$ -</u>	<u>\$ 15,766</u>
<b>December 31, 2011</b>				
	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b>Estimated Fair Value</b>
<i>(Dollars in thousands)</i>				
<b>Held-to-Maturity</b>				
Mortgage and asset-backed securities	\$ 3,104	\$ 27	\$ -	\$ 3,131
Corporate bonds	3,500	-	(93)	3,407
	<u>\$ 6,604</u>	<u>\$ 27</u>	<u>\$ (93)</u>	<u>\$ 6,538</u>

See accompanying notes.

**MISSION VALLEY BANCORP**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

Information pertaining to investment securities with gross unrealized losses at December 31, 2012 and 2011 aggregated by investment category and length of time that individual securities have been in continuous loss position is as follows:

	<u>December 31, 2012</u>		<u>December 31, 2011</u>	
	<u>Less Than 12 Months</u>		<u>Less Than 12 Months</u>	
	<u>Estimated Fair Value</u>	<u>Unrealized Losses</u>	<u>Estimated Fair Value</u>	<u>Unrealized Losses</u>
<i>(Dollars in thousands)</i>				
<b>Available-for-Sale</b>				
Agency securities	\$ 999	\$ (1)	\$ -	\$ -
Mortgage and asset-backed securities	5,382	(12)	-	-
	<u>\$ 6,381</u>	<u>\$ (13)</u>	<u>\$ -</u>	<u>\$ -</u>
	<u>December 31, 2012</u>		<u>December 31, 2011</u>	
	<u>Less Than 12 Months</u>		<u>Less Than 12 Months</u>	
	<u>Estimated Fair Value</u>	<u>Unrealized Losses</u>	<u>Estimated Fair Value</u>	<u>Unrealized Losses</u>
<i>(Dollars in thousands)</i>				
<b>Held-to-Maturity</b>				
Corporate Bonds	\$ -	\$ -	\$ 3,407	\$ (93)
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 3,407</u>	<u>\$ (93)</u>

At December 31, 2012 there were five available for sale and no held-to-maturity securities in an unrealized loss position. At December 31, 2011, there were no available for sale securities and two held-to-maturity securities that were in an unrealized loss position. No securities were in an unrealized position for more than twelve months.

Management evaluates securities for OTTI at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value, which may be maturity. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's financial condition. The Company does not have any securities that were considered to be other than temporarily impaired in 2012 or 2011.

**MISSION VALLEY BANCORP**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

The amortized cost and estimated fair values of investment securities (excluding mutual fund investments which do not have stated maturities) at December 31, 2012 and 2011, by contractual maturity, are shown below. Expected and actual maturities may differ from contractual maturities because issuers or borrowers may have the right to call or prepay obligations with or without prepayment penalties.

	<u>December 31, 2012</u>		<u>December 31, 2011</u>	
	<u>Amortized Cost</u>	<u>Estimated Fair Value</u>	<u>Amortized Cost</u>	<u>Estimated Fair Value</u>
<i>(Dollars in thousands)</i>				
<b>Available-for-Sale</b>				
Due in one year or less	\$ 12	\$ 12	\$ -	\$ -
Due from one to five years	1,623	1,633	2,110	2,140
Due in more than five years	20,270	20,513	12,530	12,804
	<u>\$ 21,905</u>	<u>\$ 22,158</u>	<u>\$ 14,640</u>	<u>\$ 14,944</u>
	<u>December 31, 2012</u>		<u>December 31, 2011</u>	
	<u>Amortized Cost</u>	<u>Estimated Fair Value</u>	<u>Amortized Cost</u>	<u>Estimated Fair Value</u>
<i>(Dollars in thousands)</i>				
<b>Held-to-Maturity</b>				
Due from one to five years	\$ 3,500	\$ 3,567	\$ 3,500	\$ 3,407
Due in more than five years	2,050	2,074	3,104	3,131
	<u>\$ 5,550</u>	<u>\$ 5,641</u>	<u>\$ 6,604</u>	<u>\$ 6,538</u>

Sales of investment securities available-for-sale for the years ended December 31, 2012 and 2011 resulted in \$54,000 and \$0, respectively, in gross realized gains and no realized losses.

As of December 31, 2012 and 2011, securities pledged as collateral for borrowings and to secure U.S. Government, State & Local Agencies and trust deposits as required by contract or law were \$13,092,000 and \$11,407,000, respectively.

**MISSION VALLEY BANCORP**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 3 - Loans and Allowance for Loan Losses**

The composition of the Company's loan portfolio at December 31, 2012 and 2011 was as follows:

<i>(Dollars in thousands)</i>	<u>2012</u>	<u>2011</u>
Real estate loans	\$ 94,315	\$ 91,851
Commercial loans	41,782	36,395
Consumer loans	4,627	5,891
SBA loans	7,532	10,423
Accounts Receivable loans	15,812	15,950
Leasing	907	1,309
Advanced Restaurant Financing	11,535	12,672
Overdrafts	<u>137</u>	<u>354</u>
Gross loans	176,647	174,845
Less:		
Allowance for loan losses	5,209	5,306
Discount on retained loans	163	-
Deferred loan fees (costs), net	<u>(491)</u>	<u>72</u>
Net loans	<u>\$ 171,766</u>	<u>\$ 169,467</u>

The adequacy of the allowance for loan losses is determined by the Company's management based upon evaluation and review of credit quality of the loan portfolio, consideration of historical loss experience, relevant internal and external factors that affect the collection of a loan, and other pertinent factors. The allowance for loan loss analysis is a formula methodology based upon assigning a risk rating to each loan upon loan origination and is periodically reassessed and validated during the term of the loan through the Company's credit review processes. The Company's risk rating methodology assigns risk ratings ranging from 1 to 9 where a higher rating represents a higher risk.

Additionally, the Company's management utilizes qualitative adjustments to the allowance for loan loss analysis in order to systematically quantify the credit risk impact of other trends and changes within the loan portfolio. The qualitative factors consider the following nine factors, which are patterned after the guidelines provided under the Federal Financial Institutions Examination Council Interagency Policy Statement on the Allowance for Loan and Lease Losses issued in 2006:

- Changes in lending policies and procedures, including changes in underwriting standards and collection, charge-off, and recovery practices not considered elsewhere in estimating credit losses;
- Changes in international, national, regional, and local economic and business conditions and developments that affect the collectability of the portfolio, including the condition of various market segments;

**MISSION VALLEY BANCORP**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 3 - Loans and Allowance for Loan Losses (continued)**

- Changes in the nature and volume of the portfolio and in the terms of loans;
- Changes in the experience and ability of lending management and other relevant staff;
- Changes in the volume and severity of past due loans, the volume of nonaccrual loans, and the volume and severity of adversely classified or graded loans;
- Changes in the quality of the institution's loan review system;
- Changes in the value of underlying collateral for collateral-dependent loans;
- The existence and effect of any concentrations of credit, and changes in the level of such concentrations; and
- The effect of other external factors such as competition and legal and regulatory requirements on the level of estimated credit losses in the institutions' existing portfolio.

The Company also establishes specific loss allowances for loans where management has identified potential credit risk conditions or circumstances related to a specific individual credit. The specific allowance amounts are determined by a method prescribed by FASB ASC 310-10-35-22, *Measurement of Impairment*. The loans identified as impaired will be accounted for in accordance with one of the three acceptable valuations as follows: (1) the present value of future cash flows discounted at the loan's effective interest rate; (2) the loan's observable market price; or (3) the fair value of the collateral, if the loan is collateral dependent. For the collateral dependent impaired loans, the Company obtains an appraisal to determine the amount of impairment at the date that the loan becomes impaired. If third party market data indicates that the value of collateral property values has declined since the most recent valuation date, the value of the property is adjusted downward to reflect current market conditions. If the fair value of the collateral, less cost to sell, is less than the recorded amount of the loan, the Company either recognizes impairment by creating or adjusting an existing valuation allowance with a corresponding charge to the provision for loan losses or charge-off the impaired balance on collateral dependent loans if it is determined that such loss amount represents a confirmed loss.

Management believes that the allowance for loan losses was adequate as of December 31, 2012. There is, however, no assurance that future loan losses will not exceed the levels provided for in the allowance for loan losses and could possibly result in additional charges to the provision for loan losses.

In addition, bank regulatory authorities, as part of their periodic examination of the Company, may require additional charges to the provision for loan and lease losses in future periods if warranted as a result of their review. A significant decline in real estate market values may require an increase in the allowance for loan and lease losses. The recent U.S. recession, the housing market downturn, and declining real estate values in our markets have negatively impacted aspects of the Company's

**MISSION VALLEY BANCORP**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 3 - Loans and Allowance for Loan Losses (continued)**

residential development, commercial real estate, commercial construction and commercial loan portfolios. A continued deterioration in the Company's markets may adversely affect its loan portfolio and may lead to additional charges to the provision for loan losses.

The following tables present by portfolio segment, the activity in the allowance for loan losses for the years ended December 31, 2012 and 2011. The following also presents by loan type, the balance and activity for the allowance for loan losses disaggregated on the basis of the Company's impairment measurement method and the related recorded investment in loans and leases as of and for the years December 31, 2012 and 2011. Recorded investment is defined as the unpaid principal balance, adjusted for deferred fees/costs, premiums, discounts, accrued interest, and may also reflect a previous write-down of the investment. However, for reporting purposes recorded investments for the Company approximates unpaid principal balance as the other components are not deemed material.

Allowance for Loan Losses As of and For the Year Ended December 31, 2012						
	Beginning Balance	Provision for Loan Losses charged to Expense	Charge-offs	Recoveries on Loans Previously Charged-off	Ending Balance	Ending Balance Individually Evaluated for Impairment
<i>(Dollars in thousands)</i>						
Real Estate	\$ 2,226	\$ 739	\$ (1,212)	\$ 3	\$ 1,756	\$ 1,033
Commercial	2,131	(662)	(250)	27	1,246	925
Consumer	203	(177)	-	23	49	24
SBA	115	102	-	7	224	200
Accounts Receivable	417	183	-	7	607	-
Leasing	31	32	-	-	63	48
Advance Restaurant Financing	165	(102)	-	-	63	-
Overdrafts	18	107	(4)	-	121	-
Unallocated	-	1,080	-	-	1,080	-
Total	\$ 5,306	\$ 1,302	\$ (1,466)	\$ 67	\$ 5,209	\$ 2,230

Allowance for Loan Losses As of and For the Year Ended December 31, 2011						
	Beginning Balance	Provision for Loan Losses charged to Expense	Charge-offs	Recoveries on Loans Previously Charged-off	Ending Balance	Ending Balance Individually Evaluated for Impairment
<i>(Dollars in thousands)</i>						
Real Estate	\$ 1,515	\$ 1,604	\$ (1,389)	\$ 496	\$ 2,226	\$ 402
Commercial	3,219	(316)	(793)	21	2,131	1,331
Consumer	77	121	-	5	203	128
SBA	146	(35)	-	4	115	23
Accounts Receivable	535	(9)	(145)	36	417	-
Leasing	64	(33)	-	-	31	-
Advance Restaurant Financing	165	-	-	-	165	-
Overdrafts	20	(1)	(1)	-	18	7
Unallocated	-	-	-	-	-	-
Total	\$ 5,741	\$ 1,331	\$ (2,328)	\$ 562	\$ 5,306	\$ 1,891

**MISSION VALLEY BANCORP**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 3 - Loans and Allowance for Loan Losses (continued)**

	Recorded Investment in Loans As of December 31, 2012		
	Ending Balance Individually Evaluated for Impairment	Ending Balance Collectively Evaluated for Impairment	Ending Balance
	<i>(Dollars in thousands)</i>		
Real Estate	\$ 7,791	\$ 86,524	\$ 94,315
Commercial	2,412	39,370	41,782
Consumer	101	4,526	4,627
SBA	574	6,958	7,532
Accounts Receivable	-	15,812	15,812
Leasing	97	810	907
Advance Restaurant Financing	-	11,535	11,535
Overdrafts	-	137	137
Total	\$ 10,975	\$ 165,672	\$ 176,647

	Recorded Investment in Loans As of December 31, 2011		
	Ending Balance Individually Evaluated for Impairment	Ending Balance Collectively Evaluated for Impairment	Ending Balance
	<i>(Dollars in thousands)</i>		
Real Estate	\$ 9,070	\$ 82,781	\$ 91,851
Commercial	844	35,551	36,395
Consumer	-	5,891	5,891
SBA	212	10,211	10,423
Accounts Receivable	-	15,950	15,950
Leasing	-	1,309	1,309
Advance Restaurant Financing	-	12,672	12,672
Overdrafts	-	354	354
Total	\$ 10,126	\$ 164,719	\$ 174,845

As previously noted, the Company uses several credit quality indicators to manage credit risk in an ongoing manner. The Company's primary credit quality indicators are to use an internal credit risk rating system that categorizes loans and leases into pass, special mention, or classified categories. Credit risk ratings are applied individually to all loans that have significant or unique credit characteristics that benefit from a case-by-case evaluation. The following are the definitions of the Company's credit quality indicators:

- **Pass/Watch:** Loans in all classes that comprise the commercial and consumer portfolio segments that are not adversely rated, are contractually current as to principal and interest, and are otherwise in compliance with the contractual terms of the loan or lease agreement. Management believes that there is a low likelihood of loss related to those loans that are considered pass.

**MISSION VALLEY BANCORP**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 3 - Loans and Allowance for Loan Losses (continued)**

- **Special Mention:** Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the Company's credit position at some future date.
- **Substandard:** Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the repayment of the debt. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.
- **Doubtful/Loss:** Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or repayment in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The possibility of loss is extremely high, but because of certain important and reasonably specific pending factors, which may work towards strengthening of the asset, classification as a loss (and immediate charge off) is deferred until more exact status may be determined. In certain circumstances, a Doubtful rating will be temporary, while the Company is awaiting an updated collateral valuation. In these cases, once the collateral is valued and appropriate margin applied, the remaining un-collateralized portion will be charged off. The remaining balance, properly margined, may then be upgraded to Substandard, however, must remain on non-accrual. A loss rating is assigned to loans considered un-collectible and of such little value that the continuance as an active Company asset is not warranted. This rating does not mean that the loan has no recovery or salvage value, but rather that the loan should be charged off now, even though partial or full recovery may be possible in the future.

**MISSION VALLEY BANCORP**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 3 - Loans and Allowance for Loan Losses (continued)**

The Company's credit quality indicators are periodically updated on a case-by-case basis. The following tables present by portfolio segment and by credit quality indicator, the recorded investment in the Company's loans as of December 31, 2012 and 2011:

<b>Internal Risk Rating by Loan Class For the Year Ended December 31, 2012</b>						
<i>(Dollars in thousands)</i>	<b>Pass/Watch</b>	<b>Special Mention</b>	<b>Substandard</b>	<b>Doubtful/Loss</b>	<b>Impaired</b>	<b>Total</b>
Real estate loans	\$ 83,664	\$ 2,727	\$ 133	\$ -	\$ 7,791	\$ 94,315
Commercial loans	36,288	334	2,748	-	2,412	41,782
Consumer loans	4,117	-	409	-	101	4,627
SBA loans	6,180	637	141	-	574	7,532
Accounts Receivable loans	12,812	3,000	-	-	-	15,812
Leasing	810	-	-	-	97	907
Advanced Restaurant Financing	11,535	-	-	-	-	11,535
Overdrafts	122	15	-	-	-	137
Total	<u>\$ 155,528</u>	<u>\$ 6,713</u>	<u>\$ 3,431</u>	<u>\$ -</u>	<u>\$ 10,975</u>	<u>\$ 176,647</u>

<b>Internal Risk Rating by Loan Class For the Year Ended December 31, 2011</b>						
<i>(Dollars in thousands)</i>	<b>Pass/Watch</b>	<b>Special Mention</b>	<b>Substandard</b>	<b>Doubtful/Loss</b>	<b>Impaired</b>	<b>Total</b>
Real estate loans	\$ 79,893	\$ 2,889	\$ -	\$ -	\$ 9,070	\$ 91,852
Commercial loans	33,916	363	1,272	-	844	36,395
Consumer loans	4,852	-	1,038	-	-	5,890
SBA loans	8,819	1,280	112	-	212	10,423
Accounts Receivable loans	13,022	2,928	-	-	-	15,950
Leasing	1,309	-	-	-	-	1,309
Advanced Restaurant Financing	12,672	-	-	-	-	12,672
Overdrafts	342	12	-	-	-	354
Total	<u>\$ 154,825</u>	<u>\$ 7,472</u>	<u>\$ 2,422</u>	<u>\$ -</u>	<u>\$ 10,126</u>	<u>\$ 174,845</u>

All impaired loans included in the above tables are classified as substandard.



**MISSION VALLEY BANCORP**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 3 - Loans and Allowance for Loan Losses (continued)**

The following tables present by portfolio segment, an aging analysis and the recorded investment in loans and leases past due as of December 31, 2012 and 2011:

Aging Analysis of Past Due Loans As of December 31, 2012						
	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans Receivables
<i>(Dollars in thousands)</i>						
Real Estate	\$ 632	\$ -	\$ 3,789	\$ 4,421	\$ 89,894	\$ 94,315
Commercial	-	-	614	614	41,168	41,782
Consumer	-	-	-	-	4,627	4,627
SBA	-	-	21	21	7,511	7,532
Accounts Receivable	-	-	-	-	15,812	15,812
Leasing	15	-	96	111	796	907
Advanced Restaurant Financing	-	-	-	-	11,535	11,535
Overdrafts	-	-	-	-	137	137
Total	<u>\$ 647</u>	<u>\$ -</u>	<u>\$ 4,520</u>	<u>\$ 5,167</u>	<u>\$ 171,480</u>	<u>\$ 176,647</u>

Aging Analysis of Past Due Loans As of December 31, 2011						
	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans Receivables
<i>(Dollars in thousands)</i>						
Real Estate	\$ 1,356	\$ 2,449	\$ 3,116	\$ 6,921	\$ 84,930	\$ 91,851
Commercial	200	102	-	302	36,093	36,395
Consumer	-	-	-	-	5,891	5,891
SBA	-	19	-	19	10,404	10,423
Accounts Receivable	-	-	-	-	15,950	15,950
Leasing	-	-	-	-	1,309	1,309
Advanced Restaurant Financing	-	-	-	-	12,672	12,672
Overdrafts	-	-	-	-	354	354
Total	<u>\$ 1,556</u>	<u>\$ 2,570</u>	<u>\$ 3,116</u>	<u>\$ 7,242</u>	<u>\$ 167,603</u>	<u>\$ 174,845</u>

There were no loans that were greater than ninety days past due and still accruing interest at December 31, 2012 and 2011. The recorded investment in loans and leases on nonaccrual status as of December 31, 2012 consisted of \$5,153,000 in real estate loans, \$1,636,000 in commercial loans, \$97,000 in municipal loans and \$75,000 in loans partially guaranteed by the SBA. The recorded investment in loans and leases on nonaccrual status as of December 31, 2011 consisted of \$4,810,000 in real estate loans, \$832,000 in commercial loans, and \$149,000 in loans partially guaranteed by the SBA.

**MISSION VALLEY BANCORP**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 3 - Loans and Allowance for Loan Losses (continued)**

The following tables present information related to impaired loans as of and for the years ended December 31, 2012 and 2011. The tables below do not include impaired loans in the amount of \$585,000 and \$1,556,000 that were fully reserved with allowance for loan losses for the years ended December 31, 2012 and 2011, respectively:

Impaired Loans For the Year Ended December 31, 2012					
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
<i>(Dollars in thousands)</i>					
With no related allowance recorded:					
Real estate	\$ 3,037	\$ 3,037	\$ -	\$ 2,621	\$ 223
Commercial	510	510	-	488	36
With an allowance recorded:					
Real estate	\$ 4,754	\$ 4,754	\$ 899	\$ 5,661	\$ 295
Commercial	1,902	1,902	552	1,092	110
SBA	574	574	126	313	50
Consumer	101	101	20	101	-
Leasing	97	97	48	97	8
Total:					
Real estate	\$ 7,791	\$ 7,791	\$ 899	\$ 8,282	\$ 518
Commercial	2,412	2,412	552	1,580	146
SBA	574	574	126	313	50
Consumer	101	101	20	101	-
Leasing	97	97	48	97	8

**MISSION VALLEY BANCORP**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 3 - Loans and Allowance for Loan Losses (continued)**

<b>Impaired Loans</b>					
<b>For the Year Ended December 31, 2011</b>					
<i>(Dollars in thousands)</i>	<b>Recorded Investment</b>	<b>Unpaid Principal Balance</b>	<b>Related Allowance</b>	<b>Average Recorded Investment</b>	<b>Interest Income Recognized</b>
With no related allowance recorded:					
Real estate	\$ 2,503	\$ 2,503	\$ -	\$ 3,159	\$ 226
Commercial	561	561	-	327	39
SBA	160	160	-	213	23
With an allowance recorded:					
Real estate	\$ 6,567	\$ 6,567	\$ 255	\$ 3,963	\$ 347
Commercial	283	283	57	186	17
SBA	52	52	23	59	4
Total:					
Real estate	\$ 9,070	\$ 9,070	\$ 255	\$ 7,122	\$ 573
Commercial	844	844	57	513	56
SBA	212	212	23	272	27

**Troubled Debt Restructurings**

The Company offers a variety of modifications to borrowers. The modification categories offered can generally be described in the following categories:

**Rate modification** - A modification in which the interest rate is changed.

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

**Interest only modification** - A modification in which the loan is converted to interest only payments for a period of time.

**Payment modification** - A modification in which the dollar amount of the payment is changed, other than an interest only modification described above.

**Combination modification** - Any other type of modification, including the use of multiple categories above.

**MISSION VALLEY BANCORP**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 3 - Loans and Allowance for Loan Losses (continued)**

As of December 31, 2012, there were 31 restructured loans in the amount of \$5,075,000 with a \$1,105,000 allocated allowance included within the impaired loan balance as of December 31, 2012.

As of December 31, 2011, there were 39 restructured loans in the amount of \$10,015,000 with a \$1,689,000 allocated allowance included within the impaired loan balance as of December 31, 2011.

The following tables present newly restructured loans that occurred during the twelve months ended December 31, 2012 and 2011, respectively:

	Rate		Term		Interest Only		Payment		Total	
	Modifications #	(in thousands) \$	Modifications #	(in thousands) \$	Modifications #	(in thousands) \$	Modifications #	(in thousands) \$	Modifications #	(in thousands) \$
<b>Pre-Modification Outstanding Recorded Investment:</b>										
Commercial loans & lines	-	\$ -	3	\$ 1,278	-	\$ -	-	\$ -	3	\$ 1,278
Total	-	\$ -	3	\$ 1,278	-	\$ -	-	\$ -	3	\$ 1,278

	Rate		Term		Interest Only		Payment		Total	
	Modifications #	(in thousands) \$	Modifications #	(in thousands) \$	Modifications #	(in thousands) \$	Modifications #	(in thousands) \$	Modifications #	(in thousands) \$
<b>Post-Modification Outstanding Recorded Investment:</b>										
Commercial loans & lines	-	\$ -	3	\$ 1,278	-	\$ -	-	\$ -	3	\$ 1,278
Total	-	\$ -	3	\$ 1,278	-	\$ -	-	\$ -	3	\$ 1,278

	Rate		Term		Interest Only		Payment		Total	
	Modifications #	(in thousands) \$	Modifications #	(in thousands) \$	Modifications #	(in thousands) \$	Modifications #	(in thousands) \$	Modifications #	(in thousands) \$
<b>Pre-Modification Outstanding Recorded Investment:</b>										
Commercial mortgage	-	\$ -	-	\$ -	1	\$ 200	1	\$ 2,810	2	\$ 3,010
Commercial loans & lines	1	\$ 128	1	\$ 41	1	\$ 56	2	\$ 533	5	\$ 758
Total	1	\$ 128	1	\$ 41	2	\$ 256	3	\$ 3,343	7	\$ 3,768

	Rate		Term		Interest Only		Payment		Total	
	Modifications #	(in thousands) \$	Modifications #	(in thousands) \$	Modifications #	(in thousands) \$	Modifications #	(in thousands) \$	Modifications #	(in thousands) \$
<b>Post-Modification Outstanding Recorded Investment:</b>										
Commercial mortgage	-	\$ -	-	\$ -	1	\$ 200	1	\$ 2,810	2	\$ 3,010
Commercial loans & lines	1	\$ 128	1	\$ 41	1	\$ 56	2	\$ 533	5	\$ 758
Total	1	\$ 128	1	\$ 41	2	\$ 256	3	\$ 3,343	7	\$ 3,768

The following table summarizes troubled debt restructurings that defaulted (payments past due 30 days or more) during the years ended December 31, 2012 and 2011, and for which the default occurred within twelve months of their modification date. The amounts shown are reflective of the balance at year end:

	As of December 31, 2012		As of December 31, 2011	
	Number	(in thousands) Amount	Number	(in thousands) Amount
Commercial mortgage	-	\$ -	2	\$ 49
Real estate	-	-	2	210
Commercial loans and lines	1	54	-	-
Total	1	\$ 54	4	\$ 259

**MISSION VALLEY BANCORP**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 4 - Premises and Equipment**

Premises and equipment as of December 31, 2012 and 2011 are summarized as follows:

<i>(Dollars in thousands)</i>	<u>2012</u>	<u>2011</u>
Building improvements	\$ 2,066	\$ 2,066
Furniture, fixtures, and equipment	<u>2,853</u>	<u>2,950</u>
	4,919	5,016
Less accumulated depreciation and amortization	<u>(4,416)</u>	<u>(4,178)</u>
	<u>\$ 503</u>	<u>\$ 838</u>

Depreciation and amortization expense for the years ended December 31, 2012 and 2011 amounted to \$431,000 and \$437,000, respectively.

**Note 5 - Deposits**

At December 31, 2012, the scheduled maturities of time deposits are as follows:

<i>(Dollars in thousands)</i>	<u>Time Deposits under \$100,000</u>	<u>Time Deposits \$100,000 and Over</u>
<u>Matures during year ending December 31,</u>		
2013	\$ 4,709	\$ 36,448
2014	332	9,493
2015	417	5,047
2016	176	1,352
2017	<u>168</u>	<u>-</u>
	<u>\$ 5,802</u>	<u>\$ 52,340</u>

**Note 6 - Borrowings**

The Company has a line of credit available from the FHLB, which is secured by pledged loans. Borrowings may include overnight advances as well as loans with terms of up to 30 years. At December 31, 2012 and 2011, the Company had fixed rate borrowings of \$5,000,000 and \$21,000,000, respectively, maturing in March 2013 with an average annual weighted rate of 1.85% and 1.59%, respectively. The Company had \$58,721,000 and \$28,326,000 of borrowing capacity from the FHLB at December 31, 2012 and 2011, respectively, based upon loans and securities available to be pledged.

**MISSION VALLEY BANCORP**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 6 - Borrowings (continued)**

The Company has an unsecured revolving line of credit with PCBB providing for federal fund purchases up to \$8,200,000, \$8,000,000 with Zions Bank and up to \$5,000,000 with Union Bank. Borrowings are payable on demand and interest on outstanding borrowings accrues at rates negotiated at the time of the borrowing. As of December 31, 2012 and 2011, the Company did not have an outstanding balance against these lines of credits.

**Note 7 - Junior Subordinated Deferrable Interest Debentures**

The Mission Valley Statutory Trust I ("the Trust") was formed by the Company for the sole purpose of issuing trust preferred securities fully and unconditionally guaranteed by the Company. For financial reporting purposes, the Trust is not consolidated and the fixed rate junior subordinated deferrable interest debentures held by the Trust, issued and guaranteed by the Company, are reflected in borrowings within the Company's consolidated statements of financial condition.

On September 16, 2005, the Trust issued \$6,000,000 fixed rate Capital Trust Pass-Through Securities (TRUPS) with a liquidation value of \$1,000 per security for gross proceeds of \$6,000,000. The entire proceeds of the issuance were invested by the Trust in \$6,186,000 of junior subordinated deferrable interest debentures issued by the Company with identical maturity, repricing, and payment terms as the TRUPS. These debentures represent the sole assets of the Trust and mature on December 15, 2035, and bear interest at 5.97% through September 15, 2010 and variable rate equal to LIBOR plus 1.50% from September 15, 2010 through maturity. Interest payments are due on a quarterly basis. The interest is deferrable, at the Company's option for a period of up to twenty consecutive quarterly periods, but in any event not beyond September 16, 2035.

**Note 8 - Income Taxes**

The provision for income taxes for years ended December 31, 2012 and 2011 consisted of the following:

<i>(Dollars in thousands)</i>	<u>2012</u>	<u>2011</u>
Current		
Federal	\$ 357	\$ 162
State	<u>34</u>	<u>53</u>
	<u>391</u>	<u>215</u>
Deferred		
Federal	162	361
State	<u>89</u>	<u>45</u>
	<u>251</u>	<u>406</u>
	<u>\$ 642</u>	<u>\$ 621</u>

**MISSION VALLEY BANCORP**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 8 - Income Taxes (continued)**

A reconciliation of the Company's effective tax rate with the statutory Federal income tax rate for years ended December 31, 2012 and 2011 is as follows:

	2012		2011	
<i>(Dollars in thousands)</i>				
Statutory Federal income tax rate	\$ 581	34.0 %	\$ 604	34.0 %
State franchise tax, net of federal benefit	122	7.1	127	7.0
Tax exempt interest	(15)	(0.9)	(22)	(1.0)
BOLI	(80)	(4.7)	(80)	(5.0)
Other	34	2.1	(8)	0.0
	<u>\$ 642</u>	<u>37.6 %</u>	<u>\$ 621</u>	<u>35.0 %</u>

Change in deferred taxes of \$19,000 and \$4,000 related to unrealized gains and losses on investment securities available-for-sale during 2012 and 2011, respectively, were allocated to other comprehensive income (loss).

The following is a summary of the components of the net deferred tax asset at December 31, 2012 and 2011:

	2012	2011
<i>(Dollars in thousands)</i>		
Deferred tax assets:		
Allowance for loan losses	\$ 1,591	\$ 1,679
Depreciation and amortization	579	380
State tax	12	77
Non-accrual interest	49	141
Deferred compensation	325	283
Other, net	50	52
Total deferred tax assets	<u>2,606</u>	<u>2,612</u>
Deferred tax liabilities:		
Certain prepaid assets	(403)	(329)
Unrealized gain on investment securities	(115)	(134)
Bank Enterprise Award (BEA)	(1,395)	(1,224)
Total deferred tax liabilities	<u>(1,913)</u>	<u>(1,687)</u>
Net deferred tax asset	<u>\$ 693</u>	<u>\$ 925</u>

Management believes, based upon the Company's historical performance and future projections, it is more likely than not the deferred tax asset will be realized in the normal course of operations and has determined that no valuation allowance is necessary as of December 31, 2012 and 2011, respectively.

**MISSION VALLEY BANCORP**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 8 - Income Taxes (continued)**

The Company recognizes the tax benefit from uncertain tax positions only if it is more likely than not that the tax positions will be sustained on examination by the tax authorities, based on the technical merits of the position. The tax benefit is measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement.

The Company recognizes interest and penalties related to income tax matters in income tax expense. The Company does not anticipate that the amount of unrecognized tax benefits will significantly increase or decrease in the next twelve months. There were no interest and penalties accrued for the years ended December 31, 2012 and 2011. The Company files income tax returns in the U.S. federal jurisdiction and in California. The Company is no longer subject to U.S. federal tax authority examination for years before 2009 and California state tax authority examinations for years before 2008.

**Note 9 - Employee Benefit Plans**

The Company has established a 401(k) Plan for the benefit of eligible employees, whereby each employee being at least twenty-one years of age may become a participant at specified intervals. Employees may contribute up to 50% of their annual compensation to the 401(k) Plan each year subject to certain limits based on federal tax laws. The Company may elect to make some level of matching contributions to the Plan at the discretion of the Board of Directors. Matching contributions of \$124,000 and \$122,000 were made for the years ended December 31, 2012 and 2011, respectively.

The Company sponsors a supplemental executive retirement plan ("SERP") which is a nonqualified unfunded pension plan covering a select group of senior executives. The plan provides a retirement benefit payable in the form of a life annuity to the participants, which is based on a specified dollar amount as stated in the agreements. The accrued post retirement benefit balance was \$679,000 and \$617,000 at December 31, 2012 and 2011, respectively, and is reported in accrued interest payable and other liabilities within the consolidated statements of financial condition. The post retirement benefit expense reported within salaries, wages and employee benefits in the consolidated statements of income was \$62,000 and \$163,000 for the years ended December 31, 2012 and 2011, respectively.

**Note 10 - Stock Option Plan**

The Company has a stock option and restricted stock grant plan (the "Plan") whereby officers, directors and key employees may be granted both nonqualified and incentive stock options. Directors and other individuals who are not officers or employees may only be granted nonqualified stock options under the Plan. As of December 31, 2012, the Company had granted 459,274 options to purchase common stock at a price not less than 100% of the fair value of the stock on the date of the grant. Stock options expire no later than ten years from the date of the grant and generally vest over five years. The Plan provides for accelerated vesting if there is a change of control, as defined in the plan. When options are exercised, the

**MISSION VALLEY BANCORP**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 10 - Stock Option Plan (continued)**

Company intends to issue new stock rather than purchase stock from existing shareholders. At December 31, 2012, 67,010 options were outstanding with 304,235 options available for future issuance. No stock options were granted during 2012 and 2011.

The Company recognized share-based compensation costs (including restricted stock awards) of \$42,000 and \$89,000 for the years ended December 31, 2012 and 2011, respectively. The Company also recognized income tax benefits related to share-based compensation of approximately \$17,400 and \$44,000 for the years ended December 31, 2012 and 2011, respectively.

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

A summary of the Company's stock option plan activity for the years ended December 31, 2012 and 2011 is as follows:

	2012		2011	
	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price
<i>(Dollars in thousands)</i>				
Outstanding at beginning of year	86,010	\$ 5.88	303,640	\$ 4.37
Exercised	-	-	(56,250)	3.56
Expired or forfeited	(19,000)	7.42	(161,380)	3.85
Outstanding at end of year	<u>67,010</u>	<u>\$ 5.56</u>	<u>86,010</u>	<u>\$ 5.88</u>
Options exercisable	<u>67,010</u>	<u>\$ 5.56</u>	<u>83,310</u>	<u>\$ 5.79</u>
Weighted average remaining contractual life of options outstanding	<u>1.4 years</u>		<u>2.7 years</u>	

There were no options exercised in 2012. Options exercised in 2011 had an aggregate intrinsic value (market value of the stock at the date of exercise less the exercise price) of \$100,000. The aggregate intrinsic value of options exercisable at December 31, 2012 plus options expected to vest in future years is \$0 based on a stock price of \$4.95 per share.

**Note 11 - Commitments and Contingencies**

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit. These instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized on the statements of financial condition. To mitigate this risk posed by

**MISSION VALLEY BANCORP**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 11 - Commitments and Contingencies (continued)**

these off-balance sheet exposures, the Bank has established an off-balance sheet reserve totaling \$62,000 and \$94,000 as of December 31, 2012 and 2011, respectively, included in accrued interest payable and other liabilities on the statements of financial condition.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Those guarantees are preliminarily issued to support public and private borrowing arrangements, including commercial paper, bond financing, and similar transactions. All standby letters of credit issued by the Company expire within one year of issuance.

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 many 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 credit worthiness 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.

Collateral held varies but may include receivables, inventory, property, plant, and equipment, residential properties, and income-producing commercial properties.

A summary of the contractual or notional amounts of the Company's significant off-balance sheet financial instruments as of December 31, 2012 and 2011 is as follows:

	2012	2011
<i>(Dollars in thousands)</i>		
Commitments to extend credit	\$ 24,332	\$ 25,419
Standby letters of credit	628	717
	<u>\$ 24,960</u>	<u>\$ 26,136</u>

**Litigation** - In the ordinary course of business, the Company becomes involved in litigation. Management believes, based upon opinions of legal counsel, that the disposition of all suits pending against the Company will not have a material adverse effect on its financial position or results of operations.

**Lease commitments** - The Company currently leases its administrative offices and the Sun Valley branch facility from a shareholder of the Company. The Company leases office locations and equipment which have been classified as noncancelable operating leases. These lease agreements call for various monthly payments expiring at dates through the year 2017. Rental expense for the years ended

**MISSION VALLEY BANCORP**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**Note 11 - Commitments and Contingencies (continued)**

December 31, 2012 and 2011 amounted to \$648,000 and \$540,000, respectively.

The following table shows future minimum payments under operating leases with terms in excess of one year as of December 31, 2012:

<u>Year Ending December 31,</u> <i>(Dollars in thousands)</i>	
2013	423
2014	444
2015	361
2016	336
2017	296
Thereafter	108
	<u>\$ 1,968</u>

**Note 12 - Transactions with Related Parties**

In the ordinary course of business, the Company enters into transactions with certain directors, officers and shareholders and certain affiliates of the Company.

As part of its normal banking activities, the Company has extended credit to and received deposits from certain members of its Board of Directors, major shareholders, officers as well as entities with which these individuals are associated. These related parties had deposits and loans at the Company totaling approximately \$35,281,000 and \$6,094,000, respectively, at December 31, 2012 and \$29,776,000 and \$2,137,000, respectively, at December 31, 2011. Management believes these transactions were made in the ordinary course of business on substantially the same terms and conditions, including interest rates and collateral requirements, as comparable loans and deposits with other customers, and the loans did not involve more than normal credit risk or present other unfavorable features. Each loan has been approved by the Board of Directors.

The Company entered into a lease agreement on September 5, 2003, with a related party for the leasing of the administrative offices and the Sun Valley branch facility. The lease agreement calls for rental payments of \$140,000 per year and has a term of ten years with two five year renewal options. The first renewal option was exercised subsequent to year ended December 31, 2012, and the minimum lease payments are included in the future lease commitment schedule. Management believes these transactions were made in the ordinary course of business on substantially the same terms and conditions as if the transaction would have been consummated with a non-related party.

**MISSION VALLEY BANCORP**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**Note 13 - Fair Value of Financial Instruments**

The fair value of financial instruments is the amount at which an asset or obligation could be exchanged in a current transaction between willing parties, other than in a forced liquidation. Fair value estimates are made at a specific point in time based on the type of financial instrument and relevant market information.

Because no quoted market price exists for a significant portion of the Company's financial instruments, the fair values of such financial instruments are derived based on the amount and timing of future cash flows, estimated discount rates, as well as management's best judgment with respect to current economic conditions. Many of these estimates involve uncertainties and matters of significant judgment and cannot be determined with precision.

The fair value information provided is indicative of the estimated fair values of those financial instruments and should not be interpreted as an estimate of the fair market value of the Company taken as a whole. The disclosures do not address the value of recognized and unrecognized non-financial assets and liabilities or the value of future anticipated business. In addition, tax implications related to the realization of the unrealized gains and losses could have a substantial impact on these fair value estimates and have not been incorporated into any of the estimates.

The following methods and assumptions were used to estimate the fair values of significant financial instruments which are not measured at fair value in the consolidated financial statements at December 31, 2012 and 2011.

**Cash and cash equivalents** - The carrying value of cash and cash equivalents approximate the fair value.

**Interest bearing deposits in other banks** - Interest bearing deposits in other banks are reported at their fair value based upon discounting estimated future cash flows using currently offered rates for deposits of similar maturities.

**Investment securities, held-to-maturity** - For securities held-to-maturity, the fair value is determined by quoted market prices, where available, or on observable market inputs appropriate for the type of security.

**Loans** - The Company's loan portfolio is held for investment purposes. Included in the portfolio are loans categorized as being impaired. Fair values were calculated by sorting the portfolio by different product categories such as Commercial, Real Estate and Consumer and then further segmented into fixed and variable indexes and using a discounted present value model. The model uses the Treasury yield curve, LIBOR or prime rate as the basis to derive a "risk free" rate modified for credit quality.

**MISSION VALLEY BANCORP**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 13 - Fair Value of Financial Instruments (continued)**

**Loans held for sale** - Fair value is determined based on quoted secondary market prices for similar loans, including the implicit fair value of embedded servicing rights.

**Bank owned life insurance** - The fair value of the bank owned life insurance is the cash surrender value which is also its carrying value.

**Restricted equity securities** - The carrying value of FHLB stock, CEDLI stock, and PCBB stock approximates fair value based on the redemption provisions of the respective stock.

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

**Deposits** - The fair value of deposits with no stated maturity, such as noninterest-bearing demand deposits, savings, NOW accounts and money market accounts, is equal to the amount payable on demand at the reporting date (that is, their carrying amounts). The fair value of certificates of deposit is based on the discounted value of contractual cash flows. The discount rate is estimated using the rates currently offered for deposits of similar remaining maturities. The fair value estimates do not include the benefit that results from the low-cost funding provided by the deposit liabilities compared to the cost of borrowing funds in the market.

**Borrowings and Subordinated debentures** - The fair values of other borrowed money and subordinated debentures are determined using rates currently available to the Company for debt with similar terms and remaining maturities.

**Off-balance sheet financial instruments** - The fair value of commitments to extend credit is based upon the difference between the interest rate at which we are committed to make the loans and the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities, adjusted for the estimated volume of loan commitments actually expected to close. The fair value of commitments to extend credit and standby letters of credit were not significant at either December 31, 2012 or 2011, as these instruments predominantly have adjustable terms and are of a short-term nature.

**MISSION VALLEY BANCORP**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 13 - Fair Value of Financial Instruments (continued)**

The following tables present information about the level in the fair value hierarchy for the Company's assets and liabilities that are not measured at fair value as of December 31, 2012 and 2011. Most financial assets and financial liabilities for which the carrying amount equals fair value are considered by the Company to be Level 1 measurements in the fair value hierarchy.

	2012				
	Carrying Value	Estimated Fair Value	Fair Value Measurements Using		
			Level 1	Level 2	Level 3
<i>(Dollars in thousands)</i>					
<b>Financial Assets</b>					
Cash and cash equivalents	\$ 20,921	\$ 20,921	\$ 20,921	\$ -	\$ -
Interest bearing deposit in other banks	8,290	8,276	-	-	8,276
Investment securities, held-to-maturity	5,550	5,641	-	5,641	-
Loans, net	171,766	176,635	-	-	176,635
Loans, held for sale	720	792	-	792	-
Bank owned life insurance	5,775	5,775	5,775	-	-
Restricted equity securities	1,557	1,557	1,557	-	-
Accrued interest receivable	680	680	680	-	-
<b>Financial Liabilities</b>					
Deposits	\$ 198,462	\$ 195,152	\$ -	\$ -	\$ 195,152
Borrowings	5,000	5,019	-	-	5,019
Subordinated debentures	6,186	5,413	-	-	5,413
Accrued interest payable	37	37	37	-	-

	2011				
	Carrying Value	Estimated Fair Value	Fair Value Measurements Using		
			Level 1	Level 2	Level 3
<i>(Dollars in thousands)</i>					
<b>Financial Assets</b>					
Cash and cash equivalents	\$ 31,943	\$ 31,943	\$ 31,943	\$ -	\$ -
Interest bearing deposit in other banks	11,179	11,177	-	-	11,177
Investment securities, held-to-maturity	6,604	6,538	-	6,538	-
Loans, net	169,467	173,620	-	-	173,620
Bank owned life insurance	5,579	5,579	5,579	-	-
Restricted equity securities	1,843	1,843	1,843	-	-
Accrued interest receivable	782	782	782	-	-
<b>Financial Liabilities</b>					
Deposits	\$ 187,731	\$ 185,256	\$ -	\$ -	\$ 185,256
Borrowings	21,000	21,153	-	-	21,153
Subordinated debentures	6,186	5,348	-	-	5,348
Accrued interest payable	62	62	62	-	-

The following tables present information about the Company's assets and liabilities measured at fair value on a recurring and non-recurring basis as of December 31, 2012 and 2011 and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value. In general, fair values determined by Level 1 inputs utilize quoted prices (unadjusted) for identical instruments that are highly liquid, observable and actively traded in over-the-counter markets.

**MISSION VALLEY BANCORP**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 13 - Fair Value of Financial Instruments (continued)**

Fair values determined by Level 2 inputs utilize inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-derived valuations whose inputs are observable and can be corroborated by market data. Level 3 inputs are unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability.

**Securities available for sale** - The table below presents the balance of available-for-sale securities, which is measured at fair value on a recurring basis. An independent third party performs market valuations of the Company's available-for-sale securities. The fair values are determined by using several sources for valuing securities. The techniques include pricing models that vary based on the type of asset being valued and incorporate available trade, bid, and other market information. Market valuation sources include observable market inputs and are therefore considered Level 2 inputs for purposes of determining the fair values.

**Impaired loans** - The impaired loans amount below represents collateral dependent loans that have been adjusted to fair value. The fair value measurement is based on the current fair value of the collateral, less selling costs. Depending on the characteristics of a loan, the fair value of collateral is generally estimated by obtaining independent external appraisals. If the value of the impaired loan is less than the recorded investment in the loan, we recognize this impairment and adjust the carrying value of the loan to fair value through the allowance for loan losses. The loss represents charge-offs or impairments on collateral dependent loans for fair value adjustments based on the fair value of collateral.

**Other real estate owned** - The estimated fair value of other real estate owned is based on the appraised values or other information for the estimated fair values of such assets.

**MISSION VALLEY BANCORP**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 13 - Fair Value of Financial Instruments (continued)**

	<b>December 31, 2012</b>				
<i>(Dollars in thousands)</i>	<b>Total</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total Losses Level 3</b>
<b>Recurring items:</b>					
Agency securities	\$ 2,002	\$ -	\$ 2,002	\$ -	\$ -
Mortgage backed securities	18,558	-	18,558	-	-
Corporate bonds	1,025	-	1,025	-	-
Municipal investments	573	-	573	-	-
Mutual funds	828	828	-	-	-
	<u>\$ 22,986</u>	<u>\$ 828</u>	<u>\$ 22,158</u>	<u>\$ -</u>	<u>\$ -</u>
<b>Nonrecurring items:</b>					
Other real estate owned	\$ 192	\$ -	\$ -	\$ 192	\$ -
Impaired loans	5,783	-	-	5,783	1,558
	<u>\$ 5,975</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 5,975</u>	<u>\$ 1,558</u>
	<b>December 31, 2011</b>				
<i>(Dollars in thousands)</i>	<b>Total</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total Losses Level 3</b>
<b>Recurring items:</b>					
Mortgage backed securities	\$ 12,934	\$ -	\$ 12,934	\$ -	\$ -
Corporate bonds	2,010	-	2,010	-	-
Mutual funds	822	822	-	-	-
	<u>\$ 15,766</u>	<u>\$ 822</u>	<u>\$ 14,944</u>	<u>\$ -</u>	<u>\$ -</u>
<b>Nonrecurring items:</b>					
Impaired loans	\$ 6,567	\$ -	\$ -	\$ 6,567	\$ 719



**MISSION VALLEY BANCORP**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 14 - Regulatory Matters**

The Company and the Bank are subject to various regulatory capital requirements administered by federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Bank's and Company's financial statements.

Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum ratios of Total and Tier I capital to risk-weighted assets and of Tier I capital to average assets. As of December 31, 2012 and 2011, management believes that the Bank meets all capital adequacy requirements to which they are subject.

As of December 31, 2012, the most recent notification from the Federal Deposit Insurance Corporation categorized the Bank as well-capitalized under the regulatory framework. To be categorized as well-capitalized, the Bank must maintain minimum total risk-based, Tier I risk-based, and Tier I leverage ratios as set forth in the table below. There are no conditions or events since that notification that management believes have changed the Bank's category

The Bank's actual capital amounts and ratios computed in accordance with bank regulatory requirements as of December 31, 2012 and 2011 are as follows (amounts are in thousands of dollars). The Company's and Bank's capital amounts and ratios are substantially the same.

	Amount of Capital Required					
	Actual		Minimum Capital Requirement		Minimum To Be Well-Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<i>(Dollars in thousands)</i>						
<b>As of December 31, 2012</b>						
Total Capital to risk-weighted assets	\$ 37,753	19.47%	\$ 15,512	8.00%	\$ 19,390	10.00%
Tier 1 Capital to risk-weighted assets	35,294	18.20%	7,756	4.00%	11,634	6.00%
Tier 1 Capital to average assets	35,294	14.38%	9,816	4.00%	12,271	5.00%
<b>As of December 31, 2011</b>						
Total Capital to risk-weighted assets	\$ 36,672	19.34%	\$ 15,169	8.00%	\$ 18,962	10.00%
Tier 1 Capital to risk-weighted assets	34,264	18.07%	7,585	4.00%	11,917	6.00%
Tier 1 Capital to average assets	34,264	13.94%	9,834	4.00%	12,292	5.00%

**MISSION VALLEY BANCORP**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 15 - U.S. Treasury Capital Purchase Program, Community Development Capital Initiative Program and Trust Preferred Shares**

During 2009, the Company was a participant in the U.S. Treasury Capital Purchase Program ("CPP"), under which the Company issued preferred stock shares to the Treasury for an aggregate purchase price of \$5,500,000. On August 20, 2010, Mission Valley Bancorp completed an exchange of its CPP capital into the Community Development Capital Initiative ("CDCI") program. Under both programs the Company is subject to certain restrictions and requirements, such as restrictions on repurchases of preferred stock shares and payment of dividends, requirements relating to executive compensation, and corporate governance practices.

Mission Valley Bancorp was able to participate in the CDCI program because the bank was recognized as a Community Development Financial Institution ("CDFI") since 2006. The CDFI Fund was created for the purpose of promoting economic revitalization and community development through investment in, and assistance to, community development financial institutions (CDFIs).

As a result, 5,500 shares of Series A, 5% fixed rate, non-voting, non-cumulative perpetual preferred shares were exchanged for 5,500 shares of Series C, 2% fixed rate, non-voting, noncumulative perpetual preferred shares. This was a noncash transaction in 2010.

On September 24, 2010, Mission Valley Bancorp received an additional \$4,836,000 in capital via the CDCI program. As a result, 4,836 shares of Series D, 2% fixed rate non-voting non-cumulative perpetual preferred shares were issued for an aggregate issue price of \$4,836,000. Series C and D preferred shares qualify as Tier 1 capital.

Series C and D have a dividend rate of 2% per annum for eight years escalating to 9% for an additional five years. Series C and D have quarterly dividend payments payable on each February 15, May 15, August 15 and November 15. During 2012 and 2011, the Company declared and paid dividends on Series C and D in the cumulative amount of \$206,000 and \$221,000, respectively.

On December 31, 2009, the Company issued and sold 458,000 shares of 6% mandatory convertible cumulative preferred stock, Series B, for an aggregate price of \$4,580,000. These preferred shares qualify as Tier 1 capital. Series B dividend payments are payable semiannually at the rate of 6% per annum on each of June 15 and December 15. During 2012 and 2011, the Company declared and paid dividends on Series B in the cumulative amount of \$275,000 and \$274,000, respectively.

The Preferred Shares will mandatorily convert on December 15, 2014 into shares of Common Shares at the conversion rate equal to the quotient of the sum of \$10 plus any unpaid dividends on the Preferred Shares after issuance divided by the higher of (i) 100% of the book value per Common Share as of the calendar quarter-end immediately prior to the conversion date (adjusted for any stock splits, stock dividends and certain other events after such quarter-end and prior to the conversion date) or (ii) the market value of a Common Share as of the calendar quarter end immediately prior to the conversion (adjusted for any stock splits, stock dividends and certain other events after such quarter-end and prior

**MISSION VALLEY BANCORP**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 15 - U.S. Treasury Capital Purchase Program, Community Development Capital Initiative Program and Trust Preferred Shares (continued)**

to the conversion date), up to a maximum of 1.1 times book value referenced in (i). Holders of Preferred Shares may, at their option, convert their Preferred Shares into Common Shares at the Conversion Rate prior to the Mandatory Conversion Date. The Preferred Shares when issued and the Common Shares when issued upon conversion of the Preferred Shares will be restricted and will contain a restrictive legend as to the transferability, unless an applicable securities law exemption applies as determined by the Company, in its sole discretion with advice of counsel.

If the Company does not declare a dividend on the preferred shares in respect to any dividend period, the Company shall have no obligation to pay a dividend for such dividend period, whether or not dividends are declared for any subsequent period. However, dividends on common stock cannot be paid if dividends on preferred stock have not been paid for the most recently completed dividend period. Furthermore, if preferred stock dividends have not been paid for an aggregate of six quarters, whether or not consecutive, Treasury can appoint two new members to the Company's Board of Directors. The Company can redeem the stock at anytime subject to approval of its banking regulators. However, the Series C and D stock must be redeemed entirely before the Series B stock can be redeemed.

**Note 16 - Parent Company Only Information**

*(Dollars in thousands)*

	<u>2012</u>	<u>2011</u>
<b>ASSETS</b>		
Cash and cash equivalents	\$ 220	\$ 903
Investment in bank subsidiary	35,641	34,456
Other assets	595	498
<b>TOTAL ASSETS</b>	<u>\$ 36,456</u>	<u>\$ 35,857</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Liabilities</b>		
Junior subordinated deferred interest debentures	\$ 6,186	\$ 6,186
Accrued interest payable and other liabilities	5	7
Total liabilities	<u>6,191</u>	<u>6,193</u>
<b>Shareholders' Equity</b>		
Preferred stock	14,916	14,916
Common stock	9,917	9,917
Additional paid in capital	191	149
Retained earnings	5,075	4,490
Accumulated other comprehensive income	166	192
Total shareholders' equity	<u>30,265</u>	<u>29,664</u>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<u>\$ 36,456</u>	<u>\$ 35,857</u>

**MISSION VALLEY BANCORP**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 16 - Parent Company Only Information (continued)**

*(Dollars in thousands)*

	<u>2012</u>	<u>2011</u>
<b>INTEREST</b>		
Interest income	\$ 5	\$ 5
Interest expense	123	114
Net interest expense	<u>(118)</u>	<u>(109)</u>
Equity in undistributed earnings of subsidiary	<u>1,211</u>	<u>1,301</u>
<b>NON-INTEREST EXPENSES</b>		
Salaries, wages and employee benefits	72	72
Occupancy and equipment expenses	8	8
Legal, professional, and consulting	35	23
Share-based compensation expense	-	5
Other operating expenses	13	32
Total non-interest expenses	<u>128</u>	<u>140</u>
<b>NET INCOME BEFORE BENEFIT FOR INCOME TAXES</b>	965	1,052
Benefit for income taxes	<u>101</u>	<u>102</u>
<b>NET INCOME</b>	<u>\$ 1,066</u>	<u>\$ 1,154</u>

**MISSION VALLEY BANCORP**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**Note 16 - Parent Company Only Information (continued)**

	<u>2012</u>	<u>2011</u>
<i>(Dollars in thousands)</i>		
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net Income	\$ 1,066	\$ 1,154
Adjustments to reconcile net income to net cash provided by operating activities:		
Restricted stock awards	42	84
Share-based compensation	-	5
Equity in undistributed earnings of subsidiary	(1,211)	(1,301)
Other	(99)	(88)
Net cash used in operating activities	<u>(202)</u>	<u>(146)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Exercise of stock options	-	200
Dividends paid on preferred securities	(481)	(481)
Net cash used in financing activities	<u>(481)</u>	<u>(281)</u>
<b>Change in Cash and Cash Equivalents</b>		
Beginning of year	(683) <u>903</u>	(427) <u>1,330</u>
End of year	<u>\$ 220</u>	<u>\$ 903</u>
<b>Supplemental Disclosures of Cash Flow Information</b>		
Interest paid	\$ 123	\$ 114

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## Board of Directors

### **Claire Bagge**

Director of Mission Valley Bancorp  
Secretary & Treasurer of  
Helicopter Accessory Service, Inc.

### **Jim Bagge**

Director of Mission Valley Bancorp  
President of  
Helicopter Accessory Service, Inc.

### **Marc Foulkrod**

Director of Mission Valley Bancorp & Bank  
Chairman and CEO of  
Avjet Corporation

### **Tamara Gurney**

President, CEO & Director of  
Mission Valley Bancorp & Bank

### **John Miller**

Director of Mission Valley Bancorp & Bank  
An investment professional who provides financial  
advisory and community bank consulting

### **Darlynn C. Morgan**

Director of Mission Valley Bancorp & Bank  
Attorney and the Founder of the  
Morgan Law Group

### **Jerold B. Neuman**

Director of Mission Valley Bancorp & Bank  
Attorney with the law firm of  
Sheppard, Mullin, Richter & Hampton, LLP

### **Earle S. Wasserman**

Director and Chairman of the Board  
Mission Valley Bancorp & Bank,  
Chairman of The Hallmark Group

## Investor Information

### ***Common Stock:***

Effective September 1, 2005, Mission Valley Bancorp's stock began trading on the Bulletin Board in the over-the-counter market with the new symbol "MVLV." As of December 31, 2012 there were approximately 250 shareholders of record and 2,631,233 shares of common stock as well as 468,336 shares of preferred stock issued and outstanding.

### ***Stock Information:***

#### **Crowell Weedon**

Troy K. Norlander, Managing Director  
Michael Natzic, Senior Vice President  
(909)584-4500 / (800) 288-2811

#### **McAdams Wright Ragen, Inc.**

Joey Warmenhoven  
Senior Vice President  
(866) 662-0351

#### **Raymond James & Assoc.**

John Cavender  
(888) 317-8986

### ***Stock Transfer Agent:***

Shareholders with inquiries regarding accounts, lost stock certificates or changes of address, may contact either Linda Rousseau, Corporate Secretary of Mission Valley Bancorp at (818) 394-2331 or Computershare by calling (800) 962-4284 or (303) 262-0600 between 9:00 a.m. and 5:00 p.m. (MST). Written correspondence may be sent to:

Computershare  
350 Indiana Street, Suite 350  
Golden, CO 80401

## Management & Officers

### **Senior Management:**

#### **Tamara Gurney**

President  
Chief Executive Officer

#### **Diane Auten**

Senior Vice President  
Chief Financial Officer

#### **Marianne Cederlind**

Senior Vice President  
Chief Business Banking Officer

### **Administrative Officers:**

#### **Cindy Albers**

Vice President, CRCM  
Compliance Manager

#### **Elia Blankenship**

Vice President  
Service Manager

#### **Carrie Burrell**

Vice President, CFMP  
Marketing Manager

#### **Sandy Konish**

Vice President  
Product, Application & Core Specialist

### **Sun Valley Office:**

#### **Jahun Smith**

Vice President  
Branch Manager

#### **Arcides "Ace" Amaya**

Vice President  
Business Banker

#### **Lola Forbis**

Vice President  
Relationship Manager

#### **Carlos Guillen**

Vice President  
Operations Manager

#### **Angela Rivers**

Senior Vice President  
Chief Credit Officer

#### **Linda Rousseau**

Senior Vice President  
Chief Administrative Officer

#### **Wayne Wirth**

Senior Vice President  
SBA Manager

#### **Sally Reichhardt**

Assistant Vice President  
Deposit Operations Manager

#### **Janet Shinkle**

Vice President  
Accounts Receivable Relationship Manager

#### **Christine Tonello**

Vice President  
Credit Administrator

#### **Frank Wong**

Vice President  
Controller

### **Santa Clarita Valley:**

#### **Marti Heinbaugh**

Vice President  
Regional Manager

#### **Patricia Artavia**

Assistant Vice President  
Operations Manager  
Valencia Office

#### **Caleb Willis**

Vice President  
Relationship Manager

#### **Laura Soto**

Assistant Vice President  
Operations Manager  
Centre Pointe Office



**MISSION VALLEY BANK**

**Corporate Offices & Sun Valley Branch Office**

9116 Sunland Boulevard • Sun Valley, CA 91352 • **(818) 394-2300**

**Centre Pointe Branch & Business Banking Office**

26415 Carl Boyer Drive • Santa Clarita, CA 91350 • **(661) 253-9500**

**Valencia Branch Office**

25060 West Avenue Stanford • Valencia, CA 91355 • **(661) 775-4100**

[www.MissionValleyBank.com](http://www.MissionValleyBank.com)



Backed by  
the full faith  
and credit  
of the  
United States  
government

Each depositor insured to at least \$250,000



Federal Deposit Insurance Corporation www.fdic.gov