Community BANK OF THE BAY®

home of the BAY AREA GREEN FUND

Annual Report 2015

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Experience Officer

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Kim Ramirez
VP, Oakland Branch Manager

Eugene Jeanne
VP, Controller

Community

BANK OF THE BAY

Dear Community Bank of the Bay Shareholder:

In its own way 2015 showed just how far we've come as an institution. The year started out with gratifying recognition for prior achievements. We received a number of industry awards, including our second Bauer Financial 5-star rating, our second Findley Premier Performer rating, and the singular Community Bank of the Year award from the 700+ member Western Independent Bankers Association.

Asset and earnings growth continued to post records, and after only nine months, our year to date pre-tax profit of $2.1 million was just $100 thousand behind what was previously our best full year result. It was shaping up to be another record year.

Then at year's end, two loan relationships experienced credit issues. The specific charge offs and associated adjustments to our loan loss reserve methodology required a relatively large loan loss reserve contribution. We recovered a substantial portion of the troubled credits in the subsequent quarter, but it is noted that in years past such a reserve allocation would have surely caused a loss; however, due to our greatly improved earnings we were still able to have reported a profit for the quarter and the bank finished 2015 with sixteen consecutive quarterly profits.

Key shareholder metrics also continued to improve. In the six years since our last capital raise, we have increased book value per share by 130%. We have made great progress in earning back the negative retained earnings that once stood at over $10 million. By 2015 we had regained over 60% of that deficit, and if our profitability continues at its current pace we would wipe out the deficit entirely by late 2017 or early 2018.

As we entered 2016 we looked to build for the future. We added to our already talented team by hiring experienced individuals in credit administration, compliance and finance. We recognized the contributions of two of our senior executives by announcing their promotions to "C-level positions." Mark Roach was named Chief Banking Officer, with responsibility over all loan production. Margaret ("Margie") Perry was named Chief Customer Experience Officer with responsibility over client interaction and engagement. These two positions will give us more consistency across the organization and the different delivery channels that we use.

Finally, with 2016 our Twentieth Anniversary Year we sought to improve how we tell our story. We wanted to better communicate the impact we make on the economic well being of our clients and communities. Therefore, among other initiatives, we undertook a complete rebuild of our website to convey that story. We are excited to unveil it for you at our annual meeting on December 13, 2016. Please do attend so that all of us in the Community Bank of the Bay family can celebrate our 20th Anniversary Year together.

Sincerely,

William E. Purcell
Chairman, Board of Directors

William S. Keller
President & CEO

Report of Independent Auditors and
Financial Statements

Community Bank of the Bay

December 31, 2015 and 2014

MOSS-ADAMS LLP

Certified Public Accountants | Business Consultants

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MOSS ADAMS LLP
Certified Public Accountants | Business Consultants

REPORT OF INDEPENDENT AUDITORS

The Board of Directors and Shareholders
Community Bank of the Bay

Report on the Financial Statements
We have audited the accompanying financial statements of Community Bank of the Bay (the Bank), which comprise the balance sheets as of December 31, 2015 and 2014, and the related statements of income, comprehensive income, shareholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

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

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Bank's preparation and fair presentation of the 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 Bank'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 financial statements.

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

Opinion
In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Community Bank of the Bay as of December 31, 2015 and 2014, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Moss Adams LLP

Stockton, California
June 9, 2016

FINANCIAL STATEMENTS

ASSETS

	DECEMBER 31, 2015	DECEMBER 31, 2014
Cash and due from banks	$ 17,925,265	$ 24,077,279
Federal funds sold	250,651	205,852
Total cash and cash equivalents	18,175,916	24,283,131
Interest-bearing deposits in banks	14,412,000	12,893,000
Available-for-sale investment securities	3,819,462	7,164,184
Loans, held for sale	1,879,946	582,950
Loans, less allowance for loan losses of $3,487,978 in 2015 and $2,782,969 in 2014	194,821,624	171,731,626
Premises and equipment, net	658,649	696,363
Bank-owned life insurance	3,906,471	3,789,354
Other real estate owned	-	970,911
Interest receivable and other assets	4,148,646	3,134,307
Total assets	$ 241,822,714	$ 225,245,826

LIABILITIES AND SHAREHOLDERS' EQUITY

	2015	2014
Deposits		
Non-interest bearing	$ 72,389,736	$ 57,963,905
Interest bearing	145,580,146	140,857,217
Total deposits	217,969,882	198,821,122
Federal Home Loan Bank advances and other borrowings	-	3,999,388
Interest payable and other liabilities	1,283,231	1,404,807
Total liabilities	219,253,113	204,225,317
Commitments and contingencies (Note 10)		
Shareholders' equity		
Preferred stock, no par value; 10,000,000 shares authorized; 4,060 shares issued and outstanding in 2015 and 2014	4,060,000	4,060,000
Class A common stock, voting, no par value; 10,000,000 shares authorized; 4,175,591 and 4,163,591 shares issued and outstanding in 2015 and 2014, respectively	21,528,681	21,166,608
Class B common stock, non-voting, no par value; 10,000,000 shares authorized; 56,844 shares issued and outstanding in 2015 and 2014	1,421,100	1,421,100
Accumulated deficit	(4,391,342)	(5,643,039)
Accumulated other comprehensive (loss) income, net of taxes	(48,838)	15,840
Total shareholders' equity	22,569,601	21,020,509
Total liabilities and shareholders' equity	$ 241,822,714	$ 225,245,826

	YEARS ENDED DECEMBER 31, 2015	YEARS ENDED DECEMBER 31, 2014
INTEREST INCOME		
Interest and fees on loans	$ 9,975,293	$ 8,086,648
Interest on investment securities	171,083	218,813
Interest on federal funds sold	8	11
Interest on deposits in banks	298,909	257,595
	10,445,293	8,563,067
INTEREST EXPENSE		
Interest expense on deposits	789,116	619,419
Interest on borrowings	4,087	72,972
Total interest expense	793,203	692,391
Net interest income	9,652,090	7,870,676
PROVISION FOR LOAN LOSSES	1,250,000	400,000
Net interest income after provision for loan losses	8,402,090	7,470,676
NON-INTEREST INCOME		
Service charges	366,894	449,061
Government grant	265,496	355,000
Gain on sale of securities	40,365	47,623
Gain on sale of loans, net	788,191	445,666
Gain on sale of other real estate owned	63,386	-
Other income	447,433	466,697
Total non-interest income	1,971,765	1,764,047
NON-INTEREST EXPENSES		
Salaries and employee benefits	4,341,285	3,796,985
Stock option expense	331,713	181,672
Occupancy and equipment	1,336,285	1,125,465
Other expenses	2,143,675	1,923,639
Total non-interest expenses	8,152,958	7,027,761
Net operating income before provision for income taxes	2,220,897	2,206,962
INCOME TAX EXPENSE	888,000	500,000
Net income	1,332,897	1,706,962
Dividends on preferred stock	81,200	81,200
Net income available to common shareholders	$ 1,251,697	$ 1,625,762
NET INCOME PER SHARE – BASIC	$ 0.30	$ 0.39
NET INCOME PER SHARE – DILUTED	$ 0.28	$ 0.38

	YEARS ENDED DECEMBER 31,	
	2015	2014
Net income	$ 1,332,897	$ 1,706,962
Unrealized (loss) gain on available-for-sale securities	(20,077)	170,863
Reclassification adjustment for net gain realized and reported in net income	(40,365)	(47,623)
Net unrealized (losses) gains	(60,442)	123,240
Income tax expense	(4,236)	(41,902)
Other comprehensive (loss) income	(64,678)	81,338
Total comprehensive income	$ 1,268,219	$ 1,788,300

STATEMENTS OF SHAREHOLDERS' EQUITY

	Preferred Stock	Class A Common Stock		Class B Common Stock		Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
		Shares	Amount	Shares	Amount			
Balances, January 1, 2014	$ 4,060,000	4,131,924	$ 20,876,079	56,844	$ 1,421,100	$ (7,268,801)	$ (65,498)	$ 19,022,880
Stock option exercised	-	31,667	108,857	-	-	-	-	108,857
Stock option expense	-	-	181,672	-	-	-	-	181,672
Dividend paid on preferred stock	-	-	-	-	-	(81,200)	-	(81,200)
Net income	-	-	-	-	-	1,706,962	-	1,706,962
Other comprehensive loss	-	-	-	-	-	-	81,338	81,338
Balances, December 31, 2014	4,060,000	4,163,591	21,166,608	56,844	1,421,100	(5,643,039)	15,840	21,020,509
Stock option exercised	-	12,000	30,360	-	-	-	-	30,360
Stock option expense	-	-	331,713	-	-	-	-	331,713
Dividend paid on preferred stock	-	-	-	-	-	(81,200)	-	(81,200)
Net income	-	-	-	-	-	1,332,897	-	1,332,897
Other comprehensive income	-	-	-	-	-	-	(64,678)	(64,678)
Balances, December 31, 2015	$ 4,060,000	4,175,591	$ 21,528,681	56,844	$ 1,421,100	$ (4,391,342)	$ (48,838)	$ 22,569,601

STATEMENTS OF CASH FLOWS

	YEARS ENDED DECEMBER 31, 2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 1,332,897	$ 1,706,962
Adjustments to reconcile net income to net cash from operating activities:		
Provision for loan losses	1,250,000	400,000
Change in deferred loan origination fees, net	(26,776)	106,946
Depreciation, amortization, and accretion	228,715	226,170
Gain on sale of securities	(40,365)	(47,623)
Gain on sale of other real estate owned	(63,386)	-
Proceeds from the sale of loans held for sale	10,512,348	4,364,341
Originations of loans held for sale	(11,021,153)	(3,072,416)
Gain on sale of loans	(788,191)	(445,666)
Stock option expense	331,713	181,672
Increase in cash surrender value of bank owned life insurance	(117,117)	(114,770)
(Increase) decrease in interest receivable and other assets	(841,775)	182,149
(Decrease) increase in interest payable and other liabilities	(121,576)	589,063
Net cash from operating activities	635,334	4,076,828
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sold, called, and matured available-for-sale investment securities	2,304,232	4,311,981
Proceeds from principal repayments from available-for-sale investment securities	980,494	1,684,213
Purchases of available-for-sale investment securities	-	(3,590,347)
Purchase of interest-bearing deposits	(1,719,000)	(4,248,000)
Proceeds from maturities of interest-bearing deposits	200,000	1,524,744
Net increase in loans	(24,313,222)	(49,294,447)
Purchases of premises and equipment	(151,082)	(219,473)
Purchases of FHLB stock	(176,800)	(76,400)
Proceeds from sale of other real estate owned	1,034,297	-
Net cash from investing activities	(21,841,081)	(49,907,729)

	YEARS ENDED DECEMBER 31,	
	2015	2014
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase in demand, interest bearing, and savings deposits	19,924,991	41,364,391
Net (decrease) increase in time deposits	(776,231)	6,867,568
Dividends paid on preferred stock	(81,200)	(81,200)
Repayment of FHLB borrowings	(3,999,388)	(612)
Net decrease in federal funds purchased	-	(945,000)
Proceeds from exercise of stock options	30,360	108,857
Net cash from financing activities	15,098,532	47,314,004
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(6,107,215)	1,483,103
CASH AND CASH EQUIVALENTS, beginning of year	24,283,131	22,800,028
CASH AND CASH EQUIVALENTS, end of year	$ 18,175,916	$ 24,283,131
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the year for:		
Interest expense	$ 789,237	$ 689,686
Income taxes	$ 1,605,000	$ 155,000
Non-cash investing and financing activities:		
Net loans transferred to other real estate owned	$ -	$ 970,911

NOTE 1 – ORGANIZATION AND NATURE OF BUSINESS

General – Community Bank of the Bay (the Bank) is a California state chartered bank that commenced banking operations on July 22, 1996. The Bank provides a range of banking services to individuals and businesses in the greater San Francisco Bay area, especially businesses employing residents of low and moderate income neighborhoods. The Bank's primary source of revenue is generated from providing loans to customers who are predominately small and middle market businesses and individuals residing in the surrounding areas.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting and reporting policies of the Bank conform with accounting principles generally accepted in the United States of America and prevailing practices within the banking industry.

Use of estimates – The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The allowance for loan losses is the most significant accounting estimate reflected in the Bank's financial statements. The allowance for loan losses includes charges to reduce the recorded balances of loans receivable to their estimated net realizable value, as appropriate. The allowance is based on estimates, and ultimate losses may vary from current estimates. These estimates for losses are based on individual assets and their related cash flow forecasts, sales values, independent appraisals, the volatility of certain real estate markets, and concern for disposing of real estate in distressed markets. Although management of the Bank believes the estimates underlying the calculation of specific allowances are reasonable, there can be no assurances that the Bank could ultimately realize these values. In addition to providing valuation allowances on specific assets where a decline in value has been identified, the Bank establishes general valuation allowances for losses based on the overall portfolio composition, general market conditions, concentrations, and prior loss experience.

Other significant management judgments and accounting estimates reflected in the Bank's financial statements include:

- Decisions regarding the timing and placement of loans on non-accrual;
- Determination, recognition, and measurement of impaired loans;
- Determination and evaluation of deferred tax assets and liabilities;
- Determination of the fair value of stock option awards;
- Determination of the fair value of financial instruments; and
- Determination of the fair value of other real estate owned.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Concentrations of credit risk – Assets and liabilities that subject the Bank to concentrations of credit risk consist of loans and deposits. Most of the Bank's customers are located within Alameda and Contra Costa counties and the surrounding areas. The Bank's primary lending products are discussed in Note 5 to the financial statements. The Bank did not have any significant concentrations in its business with any one customer or industry. The Bank obtains what it believes to be sufficient collateral to secure potential losses on loans. The extent and value of collateral varies based upon the details underlying each loan agreement.

As of December 31, 2015 and 2014, the Bank had cash deposits at other financial institutions in excess of FDIC insured limits. However, as the Bank places these deposits with major financial institutions and monitors the financial condition of these institutions, management believes the risk of loss to be minimal.

Cash and cash equivalents – For purposes of the statement of cash flows, the Bank considers cash, due from banks, money market funds, federal funds sold, and securities purchased under agreements to resell to be cash equivalents. All have original maturities of three months or less.

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

Management determines the appropriate classification of its investment securities at the time of purchase and may only change the classification in certain limited circumstances. At December 31, 2015 and 2014, all of the Bank's investments were classified as available-for-sale.

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

Investments with fair values that are less than amortized cost are considered impaired. Impairment may result from either a decline in the financial condition of the issuing entity or, in the case of fixed interest rate investments, from rising interest rates. At each financial statement date, management assesses each investment to determine if impaired investments are temporarily impaired or if the impairment is other than temporary. This assessment includes a determination of whether the Bank intends to sell the security, or if it is more likely than not that the Bank will be required to sell the security before recovery of its amortized cost basis less any current-period credit losses. For debt securities that are considered other than temporarily impaired and that the Bank does not intend to sell and will not be required to sell prior to recovery of the amortized cost basis, the amount of impairment is separated into the amount that is credit related (credit loss component) and the amount due to all other factors. The credit loss component is recognized in earnings and is calculated as the difference between the security's amortized cost basis and the present value of its expected future cash flows. The remaining difference between the security's fair value and the present value of the future expected cash flows is deemed to be due to factors that are not credit related and is recognized in other comprehensive income (loss).

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Investment in Federal Home Loan Bank stock – In order to borrow from the Federal Home Loan Bank (FHLB), the Bank is required to maintain an investment in FHLB capital stock. The investment of $833,300 and $656,500 at December 31, 2015 and 2014, respectively, is carried at cost, redeemable at par, at the discretion of the FHLB, and included in interest receivable and other assets on the balance sheet.

Loans and loan fees – Loans are reported at their principal outstanding balance net of charge-offs. Loan origination fees and certain direct loan origination costs are deferred and the net amounts are amortized to interest income by a method that approximates a level yield over the contractual life of the underlying loans.

Income recognition on loans – Interest on loans, other than discounted installment loans, is credited to income based on the principal amount outstanding on a daily basis. Interest on discounted installment loans is recognized by a method which approximates the effective interest method. Interest accruals are discontinued on certain loans when collection of principal or interest is considered doubtful, or when a loan becomes contractually past due by 90 days or more with respect to interest or principal. When a loan is placed on non-accrual status, all interest previously accrued but not collected is reversed against current period interest income. Income on such loans is then recognized only to the extent that cash is received and where the future collection of principal is probable. Interest accruals are resumed on such loans when, in the judgment of management, the loans are estimated to be fully collectible as to both principal and interest.

Allowance for loan losses – The allowance for loan losses is established through a provision for loan losses charged to operations. The adequacy of the allowance for loan losses is periodically evaluated by the Bank in order to maintain the allowance at a level that, in the opinion of management, is adequate to absorb losses inherent in existing loans. Management's evaluation of the adequacy of the allowance is based on a consideration of the Bank's historical loss experience, known and inherent risks in the loan portfolio, including adverse circumstances that may affect the ability of the borrower to repay interest and/or principal, the estimated value of any underlying collateral, and an analysis of the levels and trends of delinquencies and charge-offs. Actual results could differ from those estimates.

When a loan or portion of a loan is determined to be uncollectible, the portion deemed uncollectible is charged against the allowance and subsequent recoveries, if any, are credited to the allowance.

The allowance consists of specific, general, and unallocated components. The specific component relates to loans that are classified as impaired. Impaired loans, as defined, are measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral, if the loan is collateral dependent. The general component relates to non-impaired loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component may be 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.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Allowance for loan losses (continued) – A loan is considered impaired if, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due, according to the contractual terms of the loan agreement.

Troubled debt restructuring – In situations where, for economic or legal reasons related to a borrower's financial difficulties, the Bank grants a concession to the borrower that it would not otherwise consider, the related loan is classified as a troubled debt restructuring. The Bank measures any loss on the troubled debt restructuring in accordance with the guidance concerning impaired loans set forth above. Additionally, loans modified in troubled debt restructurings are generally placed on non-accrual status at the time of restructuring. These loans are returned to accrual status after the borrower demonstrates performance with the modified terms for a sustained period of time (generally six months) and has the capacity to continue to perform in accordance with the modified terms of the restructured debt.

Loans held for sale – The Bank has originated government guaranteed loans to customers under the Small Business Administration (SBA) program. The SBA provides guarantees of 75% to 90% of each loan. For some of these loans, the Bank sells the guaranteed portion of the loan to a third party and retains the unguaranteed portion in its own portfolio. Loans held for sale include government loans and are reported at the lower of cost or fair value. Cost generally approximates market value, given the short duration of these assets. Gains or losses on the sale of loans that are held for sale are recognized at the time of the sale, subject to the expiration of any warranty or recourse provisions, and determined by the difference between net sale proceeds and the net book value of the loans less the estimated fair value of any retained mortgage servicing rights and estimated mark against the retained portion of the loan.

Servicing assets – Periodically, the Bank sells loans and retains the servicing rights. The gain or loss on sale of loans depends in part on the previous carrying amount of the financial assets involved in the transfer, allocated between the assets sold and the retained interests based on their relative fair value at the date of transfer. To obtain fair values, quoted market prices are used, if available. However, quotes are generally not available for retained interests, so the Bank generally estimates fair value based on the present value of future expected cash flows using management's best estimates of the key assumptions – credit losses, prepayment speeds, forward yield curves, and discount rates commensurate with the risks involved.

Total servicing assets included in other assets were $509,729 and $358,569 at December 31, 2015 and 2014, respectively. The Bank evaluated the servicing asset for impairment at December 31, 2015 and 2014 and determined that no valuation allowance was needed.

The Bank services loans that have been participated with other financial institutions totaling $35,995,851 and $28,260,807 as of December 31, 2015 and 2014, respectively. Control over these loans was surrendered without recourse and, therefore, the sold balances are not included on the Bank's balance sheets.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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

The Bank sells certain portions of government guaranteed loans in the secondary market. These sales are recorded by the Bank when control is surrendered and any warranty period or recourse provision expires. There were no warranty or recourse provisions outstanding at December 31, 2015 for loans sold during 2015 and 2014.

Premises and equipment – Premises and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization are provided for in amounts sufficient to relate the cost of depreciable assets to operations over their estimated service lives using the straight-line basis. The estimated lives used in determining depreciation are:

Leasehold improvements	5 years
Furniture, fixtures, and equipment	3 – 7 years

Leasehold improvements are amortized over the lesser of the useful life of the asset or the term of the lease. The straight-line method of depreciation is followed for all assets for financial reporting purposes, but accelerated methods are used for tax purposes. Deferred income taxes have been provided for the resulting temporary differences.

Bank-owned life insurance – The Bank has purchased insurance on the lives of Bank executives. The policies accumulate asset values to meet future liabilities including payment of employee benefits such as split dollar life insurance agreements, which provide an insurance benefit to the family of the individual on whom the policy is held. The cash surrender value of policies is recorded as an asset on the balance sheets. Increases in the cash surrender value are recorded as other non-interest income in the statements of income.

Other real estate owned – Other real estate owned is comprised of property acquired through foreclosure in satisfaction of indebtedness. These properties are recorded at fair value less estimated selling costs at the time of foreclosure establishing a new cost basis. Revised estimates to the fair value less cost to sell are reported as adjustments to the carrying amount of the asset, provided that such adjusted value is not in excess of the carrying amount at acquisition. Initial losses on properties acquired through full or partial satisfaction of debt are treated as credit losses and charged to the allowance for loan losses at the time of acquisition. Subsequent declines in value from the recorded amounts, routine holding costs, and gains or losses upon disposition, if any, are included in non-interest income or expense as incurred.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Income taxes – The Bank uses the asset and liability method to account for income taxes. Under such method, deferred tax assets and liabilities are recognized for the future tax consequences of differences between financial statement carrying amounts of existing assets and liabilities and their respective tax basis (temporary differences). Deferred tax assets and liabilities are reflected at currently enacted income tax rates applicable to the year in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes in the year of enactment.

A valuation allowance is established to the extent that it is more likely than not that the benefits associated with the deferred tax assets will not be fully realized.

The Bank had no unrecognized tax benefits at December 31, 2015 and 2014.

The Bank recognizes interest accrued and penalties related to unrecognized tax benefits in tax expense. During the years ended December 31, 2015 and 2014, the Bank recognized no interest and penalties.

With few exceptions, the Bank is no longer subject to examinations by U.S. federal taxing authorities for years ended before December 31, 2012, and by state authorities for years ended before December 31, 2011.

Comprehensive income – Comprehensive income includes net income and other comprehensive income. The Bank's primary source of comprehensive income is unrealized gains and losses on securities available for sale. Reclassification adjustments result from gains or losses on securities that are realized and included in net income of the current period that also had been included in other comprehensive income as unrealized holding gains or losses in the period in which they arose. Total comprehensive income and the components of accumulated other comprehensive income are presented in the statements of comprehensive income.

Stock-based compensation – The Bank recognizes compensation expense for awards of stock options to employees and directors based on the grant-date fair value of those awards. The fair value of each option granted is estimated on the date of grant using the Black-Scholes options-pricing model. The assumptions used in this model include an estimate of expected volatility, which is based on the historical volatility of the price of similar bank stocks, and an estimate of the expected option term, which is based on consideration of the vesting period and contractual term of the option. In addition, the Bank estimates the number of options expected to be forfeited based on historical forfeiture rates. The risk-free interest rates are equal to the U.S. Treasury yield at the time of the grant and commensurate with the expected term of the grant. Expense is recognized over the vesting period of the options. The Bank's stock compensation plan and related assumptions used in determining the fair value of awards are discussed in Note 11.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Advertising costs – The Bank expenses advertising costs as they are incurred. Advertising expense was $136,405 and $128,018 for the years ended December 31, 2015 and 2014, respectively.

Net income per share – Basic net income per share amounts are computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding during the year. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock, such as stock options, result in the issuance of common stock which share in the earnings of the Bank. The treasury stock method is applied to determine the dilutive effect of stock options when computing diluted earnings per share. However, dilutive earnings per share amounts are not presented when a net loss occurs because the conversion of potential common stock is anti-dilutive.

Recent accounting pronouncements – adoption of new accounting standards – In January 2014, the FASB issued Accounting Standards Update (ASU) 2014-04 - Receivables—Troubled Debt Restructurings by Creditors (Subtopic 310-40) - Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure. This update clarifies when an in-substance repossession or foreclosure occurs, that is, when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan receivable should be derecognized and the real estate property recognized. The objective of the amendments in this update is to reduce diversity in practice. An in-substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either: (1) the creditor obtaining legal title to the residential real estate property upon completion of foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy the loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. The amendments in the update were effective beginning the first quarter of 2015 and did not have a significant impact on the Bank's financial condition or results of operations.

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers,* which creates Topic 606 and supersedes Topic 605, *Revenue Recognition.* This amendment supersedes and replaces nearly all existing revenue recognition guidance, including industry-specific guidance, establishes a new control-based revenue recognition model, changes the basis for deciding when revenue is recognized over time or at a point in time, and expands and improves disclosures. The standard is effective for public entities for interim and annual periods beginning after December 15, 2016; early adoption is not permitted. The standard allows for either full retrospective adoption, or modified retrospective adoption. In August 2015, the FASB issued ASU No. 2015-14, *Revenue from Contracts with Customers (Topic 606).* This ASU defers the effective date of ASU No. 2014-09 by one year. Application of the guidance is to be effective for interim and annual periods beginning after December 15, 2017 and the Bank does not believe this ASU will have a significant impact on the Bank's financial condition or results of operations.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Recent accounting pronouncements – adoption of new accounting standards (continued) – In January 2016, the FASB issued ASU 2016-01, *Financial Instruments - Overall.* The new guidance is intended to improve the recognition and measurement of financial instruments. The new guidance makes targeted improvements to existing U.S. GAAP by:

- Requiring equity investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income;
- Requiring public business entities to use the exit price notion when measuring fair value of financial instruments for disclosure purposes;
- Requiring separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (i.e., securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements;
- Eliminating the requirement to disclose fair value of financial instruments measured at amortized cost for organizations that are not public business entities;
- Eliminating the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; and
- Requiring a reporting organization to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk (also referred to as "own credit") when the organization has elected to measure the liability at fair value in accordance with the fair value option for financial instruments.

This amendment is effective for years beginning after December 15, 2017 and the bank does not believe this ASU will have a significant impact on the Bank's financial condition or results of operations.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842).* This ASU revises the accounting related to lessee accounting. Under the new guidance, lessees will be required to recognize a right-of-use asset and a lease liability for all leases. The new lease guidance also simplified the accounting for sale and leaseback transactions primarily due to the recognition of lease assets and lease liabilities. ASU 2016-02 is effective for the first interim period within annual periods beginning after December 15, 2018. The standard is required to be adopted using the modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. We do not anticipate that this ASU will have a significant impact on the Bank's financial statements.

NOTE 3 – CASH AND DUE FROM BANKS

Cash and due from banks includes balances with the Federal Reserve Bank and other correspondent banks. The average reserve requirements are based on a percentage of the Bank's deposit liabilities. In addition, the Federal Reserve Bank requires the Bank to maintain a certain minimum balance at all times. At December 31, 2015 and 2014, the Bank's cash balances were sufficient to comply with this reserve requirement and, therefore, no such reserve balances were required to be held with the Federal Reserve Bank.

NOTE 4 – AVAILABLE-FOR-SALE INVESTMENT SECURITIES

The amortized cost and estimated fair value of available-for-sale securities as of December 31, 2015 and 2014 are as follows:

2015	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Municipal securities (taxable)	$ 656,394	$ -	$ (19,566)	$ 636,828
Municipal securities (non-taxable)	-	-	-	-
U.S. agency	500,000	-	(12,860)	487,140
Mortgage-backed securities	1,110,467	885	(3,328)	1,108,024
CMOs	937,739	6,849	(8,003)	936,585
Corporates	651,308	42	(465)	650,885
	$ 3,855,908	$ 7,776	$ (44,222)	$ 3,819,462

2014	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Municipal securities (taxable)	$ 991,044	$ 9,823	$ (15,178)	$ 985,689
Municipal securities (non-taxable)	507,381	5,704	-	513,085
U.S. agency	500,000	-	(16,810)	483,190
Mortgage-backed securities	1,951,148	18,666	(4,929)	1,964,885
CMOs	2,534,418	30,222	(5,439)	2,559,201
Corporates	656,194	1,940	-	658,134
	$ 7,140,185	$ 66,355	$ (42,356)	$ 7,164,184

Proceeds from the sales of investment securities totaled $2,263,897 and $4,311,981 during the years ended December 31, 2015 and 2014, respectively. Gross realized gains totaled $40,365 and $55,347 during 2015 and 2014, respectively. Gross realized losses totaled $0 and $7,724 during 2015 and 2014, respectively.

NOTE 4 – AVAILABLE-FOR-SALE INVESTMENT SECURITIES (CONTINUED)

Available-for-sale investment securities with unrealized losses at December 31, 2015 and 2014, are summarized and classified according to the duration of the loss period as follows:

	2015					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Municipal securities (taxable)	$ -	$ -	$ 636,828	$ (19,566)	$ 636,828	$ (19,566)
U.S. agency	-	-	487,140	(12,860)	487,140	(12,860)
Mortgage-backed securities	835,591	(3,328)	-	-	835,591	(3,328)
CMOs	301,338	(465)	-	-	301,338	(465)
Corporates	-	-	399,215	(8,003)	399,215	(8,003)
	$ 1,136,929	$ (3,793)	$ 1,523,183	$ (40,429)	$ 2,660,112	$ (44,222)

	2014					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Municipal securities (taxable)	$ -	$ -	$ 653,352	$ (15,178)	$ 653,352	$ (15,178)
U.S. agency	-	-	483,190	(16,810)	483,190	(16,810)
Mortgage-backed securities	719,648	(1,457)	327,657	(3,472)	1,047,305	(4,929)
CMOs	473,365	(5,439)	-	-	473,365	(5,439)
	$ 1,193,013	$ (6,896)	$ 1,464,199	$ (35,460)	$ 2,657,212	$ (42,356)

Certain investment securities shown above currently have fair values less than amortized cost and, therefore, contain unrealized losses. The Bank does not have the intent to sell the investments that are temporarily impaired, and it is more likely than not that the Bank will not be required to sell those investments before recovery of the amortized cost basis. The Bank has evaluated these securities and has determined that the decline in value is not other than temporary and is related to the change in market interest rates since purchase. The decline in value is not related to any company or industry specific event. These temporary unrealized losses relate principally to current interest rates for similar types of securities. 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. There were 8 and 7 investment securities with unrealized losses at December 31, 2015 and 2014, respectively. The Bank anticipates full recovery of amortized cost with respect to these securities at maturity or sooner in the event of a more favorable market interest rate environment.

NOTE 4 – AVAILABLE-FOR-SALE INVESTMENT SECURITIES (CONTINUED)

The amortized cost and estimated fair value of available-for-sale investment securities at December 31, 2015 by contractual maturity are shown below. Expected maturities will differ from contractual maturities because the issuers of the securities may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Estimated Fair Value
Due in one year or less	$ 301,803	$ 301,338
Due after one year through five years	877,411	865,413
Due after five years through ten years	985,193	964,005
Due after ten years	1,691,501	1,688,706
	$ 3,855,908	$ 3,819,462

Investment securities with amortized costs of $536,560 and $1,344,615 and estimated fair values of $524,743 and $1,340,440 were pledged to secure public funds, lines of credit, and Federal Home Loan Bank advances at December 31, 2015 and 2014, respectively.

NOTE 5 – LOANS

Outstanding loans, by class, are summarized as follows:

	DECEMBER 31, 2015	DECEMBER 31, 2014
Commercial	$ 55,308,993	$ 56,107,356
Commercial real estate		
Non-owner occupied	53,318,482	59,606,377
Owner occupied	55,427,328	42,756,463
Construction and land	19,230,643	11,733,105
Consumer	15,140,562	4,454,476
	198,426,008	174,657,777
Deferred loan and costs, net	(116,406)	(143,182)
Allowance for loan losses	(3,487,978)	(2,782,969)
	$ 194,821,624	$ 171,731,626

Salaries and employee benefits totaling $322,000 and $358,000 have been deferred as loan origination costs for the years ended December 31, 2015 and 2014, respectively.

NOTE 5 – LOANS (CONTINUED)

The Bank has certain lending policies and procedures in place that are designed to maximize loan income within an acceptable level of risk. Management reviews and approves these policies and procedures on a regular basis. A reporting system supplements the review process by providing management with frequent reports related to loan production, loan quality, concentrations of credit, loan delinquencies, and non-performing and potential problem loans. Diversification in the loan portfolio is a means of managing risk associated with fluctuations in economic conditions.

Commercial loans are underwritten after evaluating and understanding the borrower's ability to operate profitably and prudently expand its business. Underwriting standards are designed to promote relationship banking rather than transactional banking. Once it is determined that the borrower's management possesses sound ethics and solid business acumen, the Bank's management examines current and projected cash flows to determine the ability of the borrower to repay their obligations as agreed. Commercial loans are primarily made based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not be as expected and the collateral securing these loans may fluctuate in value. Most commercial loans are secured by the assets being financed or other business assets such as accounts receivable or inventory and may incorporate a personal guarantee; however, some short-term loans may be made on an unsecured basis. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers.

Commercial real estate loans are subject to underwriting standards and processes similar to commercial loans, in addition to those of real estate loans. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts and the repayment of these loans is generally largely dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The properties securing the Bank's commercial real estate portfolio are diverse in terms of type and geographic location. This diversity helps reduce the Bank's exposure to adverse economic events that affect any single market or industry. Management monitors and evaluates commercial real estate loans based on collateral, geography, and risk grade criteria. As a general rule, the Bank avoids financing single-purpose projects unless other underwriting factors are present to help mitigate risk. The Bank also utilizes third-party experts to provide insight and guidance about economic conditions and trends affecting market areas it serves. In addition, management tracks the level of owner-occupied commercial real estate loans versus non-owner occupied loans.

NOTE 5 – LOANS (CONTINUED)

With respect to loans to developers and builders that are secured by non-owner occupied properties that the Bank may originate from time to time, the Bank generally requires the borrower to have had an existing relationship with the Bank and have a proven record of success. Construction loans are underwritten utilizing feasibility studies, independent appraisal reviews, sensitivity analysis of absorption and lease rates, and financial analysis of the developers and property owners. Construction loans are generally based upon estimates of costs and value associated with the completed project. These estimates may be inaccurate. Construction loans often involve the disbursement of substantial funds with repayment substantially dependent on the success of the ultimate project. Sources of repayment for these types of loans may be pre-committed permanent loans from approved long-term lenders, sales of developed property, or an interim loan commitment from the Bank until permanent financing is obtained. These loans are closely monitored by on-site inspections and are considered to have higher risks than other real estate loans due to their ultimate repayment being sensitive to interest rate changes, governmental regulation of real property, general economic conditions, and the availability of long-term financing.

Consumer loans primarily consist of home equity lines of credit and loans and other personal loans. The Bank originates consumer loans utilizing credit history information, debt-to-income ratio, and loan-to-value ratio analysis. The Bank also evaluates the consumer's liquid assets and their ability to supplement cash flow for debt payment. To monitor and manage consumer loan risk, policies and procedures are developed and modified, as needed. This activity, coupled with relatively small loan amounts that are spread across many individual borrowers, minimizes risk. Underwriting standards for home equity loans include, but are not limited to, a maximum loan-to-value percentage of 80%, collection remedies, the number of such loans a borrower can have at one time, and documentation requirements. Personal loans are nearly evenly split between mobile home loans along with a small number of direct auto loans and installment loans. Personal unsecured loans are offered to consumers with additional underwriting procedures in place, including net worth and borrower's verified liquid assets analysis. In general, personal loans usually have a higher degree of risk than other types of loans.

The Bank utilizes an independent third party loan review consultant to review and validate the credit risk program on a periodic basis. Results of these reviews are presented to management and the Bank's Board of Directors. The loan review process complements and reinforces the risk identification and assessment decisions made by lenders and credit personnel, as well as the Bank's policies and procedures.

NOTE 5 – LOANS (CONTINUED)

The following table summarizes the credit quality indicators related to the Bank's loans, by class, as of December 31, 2015:

	Pass	Special Mention	Substandard	Doubtful	Totals
Commercial	$ 51,004,691	$ 897,958	$ 3,406,343	$ -	$ 55,308,993
Commercial real estate					
Non-owner occupied	51,921,372	-	1,397,110	-	53,318,482
Owner occupied	51,578,945	224,642	3,623,741	-	55,427,328
Construction and land	19,230,643	-	-	-	19,230,643
Consumer	14,038,967	-	1,101,595	-	15,140,562
Total	$ 187,774,618	$ 1,122,600	$ 9,528,789	$ -	$ 198,426,008

The following table summarizes the credit quality indicators related to the Bank's loans, by class, as of December 31, 2014:

	Pass	Special Mention	Substandard	Doubtful	Totals
Commercial	$ 50,340,075	$ 3,519,565	$ 2,247,716	$ -	$ 56,107,356
Commercial real estate					
Non-owner occupied	58,487,719	-	1,118,658	-	59,606,377
Owner occupied	40,832,949	227,590	1,695,924	-	42,756,463
Construction and land	11,665,033	-	68,072	-	11,733,105
Consumer	4,395,550	58,926	-	-	4,454,476
Total	$ 165,721,326	$ 3,806,081	$ 5,130,370	$ -	$ 174,657,777

As a part of the on-going monitoring of the credit quality of the Bank's loan portfolio, management monitors certain credit quality indicators including trends related to risk grade classifications, concentrations, net charge-offs, non-performing loans, and general economic conditions.

NOTE 5 – LOANS (CONTINUED)

The Bank uses a risk grading system to assign a risk grade to each of its loans. Loans are graded on a scale of 1 to 9, with grades 1 to 5 being termed pass loans and grades 6, 7, 8, and 9 being termed special mention, substandard, doubtful, and loss, respectively. A description of the general characteristics of the nine grades is as follows:

Pass (grades 1 – 5) – These loans generally conform to the Bank's underwriting criteria and evidence an acceptable level of credit risk.

Special Mention (grade 6) – These loans have weaknesses that require management's close attention. These weaknesses expose the Bank to a sufficient degree of risk to warrant classification. If left uncorrected, these weaknesses will result in deterioration of the loan's repayment prospects or the borrower's credit position at a future date. Loans in this category are currently protected, but are potentially weak. The loans may (particularly in the short term) constitute a greater than average credit risk, but do not presently expose the Bank to a sufficient degree of risk to warrant adverse classification. This is a temporary classification pending identification of improvement or deterioration in the criticized asset.

Substandard (grade 7) – Substandard loans are inadequately protected by the current net worth and financial capacity of the borrower or the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Loss potential, while existing in the aggregate amount of substandard loans, does not have to exist in individual loans classified substandard.

Doubtful (grade 8) – Loans classified doubtful have all the weaknesses inherent in those classified as substandard with the added characteristic that the weaknesses make collection in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The probability of loss is extremely high but because of certain important and reasonably specific pending factors which may work to strengthen (or weaken) the loan, its classification as an estimated loss is deferred until its more exact status may be determined. Pending factors that may necessitate a doubtful classification include bankruptcy or liquidation procedures, capital injection, or perfecting liens on additional collateral refinancing plans. The Bank considers doubtful to be a temporary classification and will only classify an asset, or portion of an asset, as such when information is not available to conclude as to classification or more clearly define the potential for loss.

Loss (grade 9) – Assets classified loss are considered uncollectible and of such little value that their continuance as assets is not warranted. This classification does not mean that an asset has absolutely no recovery or salvage value, but rather that it is not practical or desirable to defer writing off a basically worthless asset even though partial recovery may be affected in the future. Losses are taken in the period in which they are identified as uncollectible.

NOTE 5 – LOANS (CONTINUED)

Age analysis of past due loans – The age analysis of past due loans by class as of December 31, 2015 consisted of the following:

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans	Recorded Investment > 90 Days and Accruing
Commercial	$ -	$ 1,448,508	$ 1,003,214	$ 2,451,722	$ 52,857,271	$ 55,308,993	$ -
Commercial real estate							
Non-owner occupied	244,122	-	296,735	540,857	52,777,625	53,318,482	-
Owner occupied	-	-	-	-	55,427,328	55,427,328	-
Construction and land	-	-	-	-	19,230,643	19,230,643	-
Consumer	-	549,122	98,273	647,395	14,493,167	15,140,562	-
Total	$ 244,122	$ 1,997,630	$ 1,398,222	$ 3,639,974	$ 194,786,034	$ 198,426,008	$ -

The age analysis of past due loans by class as of December 31, 2014 consisted of the following:

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans	Recorded Investment > 90 Days and Accruing
Commercial	$ -	$ -	$ -	$ -	$ 56,107,356	$ 56,107,356	$ -
Commercial real estate							
Non-owner occupied	-	-	-	-	59,606,377	59,606,377	-
Owner occupied	-	292,280	-	292,280	42,464,183	42,756,463	-
Construction and land	-	-	-	-	11,733,105	11,733,105	-
Consumer	-	-	-	-	4,454,476	4,454,476	-
Total	$ -	$ 292,280	$ -	$ 292,280	$ 174,365,497	$ 174,657,777	$ -

NOTE 5 – LOANS (CONTINUED)

Information related to impaired loans by class as of December 31, 2015 and for the year then ended consisted of the following:

	Commercial	Commercial Real Estate Non-Owner Occupied	Commercial Real Estate Owner Occupied	Construction and Land	Consumer	Total
Recorded investment in impaired loans:						
With no specific allowance recorded	$ 1,056,382	$ 1,397,110	$ 415,763	$ -	$ 668,737	$ 3,537,992
With a specific allowance recorded	1,344,403	-	-	-	432,858	1,777,261
Total recorded investment in impaired loans	$ 2,400,785	$ 1,397,110	$ 415,763	$ -	$ 1,101,595	$ 5,315,253
Unpaid principal balance of impaired loans:						
With no specific allowance recorded	$ 1,056,382	$ 1,539,751	$ 415,763	$ -	$ 668,737	$ 3,680,633
With a specific allowance recorded	1,501,874	-	-	-	432,858	1,934,732
Total unpaid principal balance of impaired loans	$ 2,558,256	$ 1,539,751	$ 415,763	$ -	$ 1,101,595	$ 5,615,365
Specific allowance	$ 66,163	$ -	$ -	$ -	$ 66,348	$ 132,511
Average recorded investment in impaired loans during the year	1,529,601	1,167,884	728,360	34,036	550,798	4,010,678
Interest income recognized in impaired loans during the year	181,037	59,641	25,433	-	24,176	290,287

Information related to impaired loans by class as of December 31, 2014 and for the year then ended consisted of the following:

	Commercial	Commercial Real Estate Non-Owner Occupied	Commercial Real Estate Owner Occupied	Construction and Land	Consumer	Total
Recorded investment in impaired loans:						
With no specific allowance recorded	$ -	$ -	$ -	$ -	$ -	$ -
With a specific allowance recorded	658,416	938,658	1,040,957	68,072	-	2,706,103
Total recorded investment in impaired loans	$ 658,416	$ 938,658	$ 1,040,957	$ 68,072	$ -	$ 2,706,103
Unpaid principal balance of impaired loans:						
With no specific allowance recorded	$ -	$ -	$ -	$ -	$ -	$ -
With a specific allowance recorded	699,835	1,041,402	1,088,440	72,257	-	2,901,934
Total unpaid principal balance of impaired loans	$ 699,835	$ 1,041,402	$ 1,088,440	$ 72,257	$ -	$ 2,901,934
Specific allowance	$ 11,517	$ 7,155	$ 45,063	$ 621	$ -	$ 64,356
Average recorded investment in impaired loans during the year	636,110	738,296	1,610,027	135,104	-	3,119,537
Interest income recognized in impaired loans during the year	8,518	60,523	32,961	-	-	102,002

NOTE 5 – LOANS (CONTINUED)

Year-end non-accrual loans, segregated by class, are as follows:

	DECEMBER 31, 2015	DECEMBER 31, 2014
Commercial	$ 1,465,220	$ 655,810
Commercial real estate		
Non-owner occupied	540,857	253,591
Owner occupied	-	593,547
Construction and land	-	68,072
Consumer	1,070,057	-
	$ 3,076,134	$ 1,571,020

Changes in the allowance for loan losses, by class, for the year ended December 31, 2015 were as follows:

	Commercial	Commercial Real Estate	Construction and Land	Consumer	Unallocated	Total
Allowance for credit losses						
Beginning balance	$ 1,097,572	$ 1,382,462	$ 155,204	$ 78,828	$ 68,903	$ 2,782,969
Charge-offs	(705,009)	-	-	-	-	(705,009)
Recoveries	73,191	83,335	-	3,492	-	160,018
Provision	952,359	(422,535)	63,748	111,669	544,759	1,250,000
Ending balance	$ 1,418,113	$ 1,043,262	$ 218,952	$ 193,989	$ 613,662	$ 3,487,978
Period-end amount allocated to:						
Loans individually evaluated for impairment	$ 66,163	$ -	$ -	$ 66,348	$ -	$ 132,511
Loans collectively evaluated for impairment	1,351,950	1,043,262	218,952	127,641	613,662	3,355,467
Ending balance	$ 1,418,113	$ 1,043,262	$ 218,952	$ 193,989	$ 613,662	$ 3,487,978
Loans						
Individually evaluated for impairment	$ 2,400,785	$ 1,812,873	$ -	$ 1,101,595	$ -	$ 5,315,253
Collectively evaluated for impairment	52,908,208	106,932,937	19,230,643	14,038,967	-	193,110,755
Ending balance	$ 55,308,993	$ 108,745,810	$ 19,230,643	$ 15,140,562	$ -	$ 198,426,008

NOTE 5 – LOANS (CONTINUED)

Changes in the allowance for loan losses, by class, for the year ended December 31, 2014 were as follows:

	Commercial	Commercial Real Estate	Construction and Land	Consumer	Unallocated	Total
Allowance for credit losses						
Beginning balance	$ 1,061,689	$ 1,193,803	$ 41,401	$ 100,406	$ -	$ 2,397,299
Charge-offs	(84,349)	(40,048)	-	-	-	(124,397)
Recoveries	106,487	-	-	3,580	-	110,067
Provision	13,745	228,707	113,803	(25,158)	68,903	400,000
Ending balance	$ 1,097,572	$ 1,382,462	$ 155,204	$ 78,828	$ 68,903	$ 2,782,969
Period-end amount allocated to:						
Loans individually evaluated for impairment	$ 11,517	$ 52,218	$ 621	$ -	$ -	$ 64,356
Loans collectively evaluated for impairment	1,086,055	1,330,244	154,583	78,828	68,903	2,718,613
Ending balance	$ 1,097,572	$ 1,382,462	$ 155,204	$ 78,828	$ 68,903	$ 2,782,969
Loans						
Individually evaluated for impairment	$ 658,416	$ 1,979,615	$ 68,072	$ -	$ -	$ 2,706,103
Collectively evaluated for impairment	55,448,940	100,383,225	11,665,033	4,454,476	-	171,951,674
Ending balance	$ 56,107,356	$ 102,362,840	$ 11,733,105	$ 4,454,476	$ -	$ 174,657,777

NOTE 5 – LOANS (CONTINUED)

The following table summarizes loans to customers whose loan terms were modified in troubled debt restructurings during the year ended December 31, 2015:

	Year ended December 31, 2015		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings			
Commercial real estate			
Non-owner occupied	1	$ 176,724	$ 176,724
Owner occupied	1	432,858	432,858
	2	$ 609,582	$ 609,582

During 2015, there were two loans that were modified and considered troubled debt restructurings because specific interest rate concessions or payment term concessions were granted to the borrower. During 2014, there were no loans where terms were modified in a troubled debt restructuring. The Bank had no obligations to lend additional funds on the restructured loans as of December 31, 2015 and 2014.

Interest recognized for cash payments received on non-accrual loans was not significant for the years ended December 31, 2015 and 2014. At December 31, 2015 and 2014, there were no loans over 90 days past due that were still accruing interest.

There were no troubled debt restructurings in 2015 and 2014 that subsequently defaulted.

NOTE 6 – PREMISES AND EQUIPMENT

Premises and equipment consisted of the following:

	DECEMBER 31, 2015	DECEMBER 31, 2014
Leasehold improvements	$ 380,570	$ 217,410
Furniture, fixtures, and equipment	626,354	718,457
	1,006,924	935,867
Less accumulated depreciation and amortization	(348,275)	(239,504)
	$ 658,649	$ 696,363

Depreciation and amortization included in occupancy and equipment expense totaled $188,796 and $146,214 for the years ended December 31, 2015 and 2014, respectively.

NOTE 7 – INTEREST-BEARING DEPOSITS

Interest-bearing deposits consisted of the following:

	DECEMBER 31, 2015	DECEMBER 31, 2014
Savings	$ 1,838,802	$ 2,820,242
Money market	70,397,310	57,627,021
NOW accounts	13,841,431	20,131,120
Time, under $250,000	35,936,488	20,002,288
Time, $250,000 or more	23,566,115	40,276,546
	$ 145,580,146	$ 140,857,217

NOTE 7 – INTEREST-BEARING DEPOSITS (CONTINUED)

Aggregate annual maturities of time deposits are as follows:

Years ending December 31,	
2016	$ 53,004,716
2017	3,400,104
2018	1,461,927
2019	560,747
2020	1,075,109
	$ 59,502,603

Interest expense related to interest-bearing deposits consisted of the following:

	YEAR ENDED DECEMBER 31,	
	2015	2014
Savings	$ 1,856	$ 3,042
Money market	409,580	276,229
NOW accounts	8,971	3,725
Time	368,709	336,423
	$ 789,116	$ 619,419

The Bank, in the normal course of business, receives deposits from its directors, officers, principal shareholders, and their associates. In management's opinion, these transactions are on substantially the same terms as comparable transactions with other customers of the Bank. The aggregate amount of deposits received from related parties at December 31, 2015 and 2014 was $1,225,895 and $582,555, respectively.

NOTE 8 – FHLB ADVANCES AND OTHER BORROWINGS

FHLB advances – During 2006, the Bank entered into an arrangement with the FHLB under which it may borrow, on either a short-term or long-term basis, up to 25% of its assets provided that adequate collateral has been pledged. Investment securities with amortized costs totaling $500,000 and $1,284,104 and estimated fair market values totaling $487,140 and $1,277,134 were pledged at December 31, 2015 and 2014, respectively.

The Bank had no outstanding secured advances at December 31, 2015. The Bank had one outstanding secured advance from the FHLB with a fixed interest rate of 0.18% and a maturity date of January 2015 at December 31, 2014.

NOTE 8 – FHLB ADVANCES AND OTHER BORROWINGS (CONTINUED)

Lines of credit – The Bank has three unsecured available lines of credit totaling $9,000,000 with three of its correspondent banks. There were no borrowings outstanding under these arrangements at December 31, 2015 and 2014, respectively. The Bank has blanket lien financing availability at the FHLB totaling $52,410,500 and $33,104,250 as of December 31, 2015 and 2014, respectively. Additionally, the Bank had collateral borrowing capacity at the FHLB totaling $11,640,415 and $14,595,857 as of December 31, 2015 and 2014, respectively. The Bank had outstanding borrowings from the FHLB totaling $0 and $3,999,388 as of December 31, 2015 and 2014, respectively.

NOTE 9 – INCOME TAXES

Income tax expense for the years ended December 31, 2015 and 2014, consists of the following:

	YEARS ENDED DECEMBER 31,	
	2015	2014
Current		
Federal	$ 1,160,000	$ 955,000
State	163,000	(20,000)
	1,323,000	935,000
Deferred		
Federal	(392,000)	(247,000)
State	(43,000)	199,800
	(435,000)	(47,200)
Change in valuation allowance	-	(387,800)
Income tax expense	$ 888,000	$ 500,000

The provision for income tax expense differs from amounts computed by applying the statutory federal income tax rate to income before income taxes primarily due to income exempt from tax, incentive stock options, and in 2014, the change in the valuation allowance.

NOTE 9 – INCOME TAXES (CONTINUED)

Deferred tax assets (liabilities) are comprised of the following:

	DECEMBER 31, 2015	DECEMBER 31, 2014
Deferred tax assets		
Net operating loss carryforwards	$ 193,000	$ 321,000
Write-down on foreclosed real estate	-	195,000
Allowance for loan losses	1,146,000	632,000
Unrealized losses on available-for-sale investment securities	15,000	-
Other	496,200	254,200
Total deferred tax assets	1,850,200	1,402,200
Deferred tax liabilities		
Depreciation on premises and equipment	(105,000)	(107,000)
Unrealized gains on available-for-sale investment securities	-	(10,000)
Other	(20,000)	(20,000)
	(125,000)	(137,000)
Valuation allowance	-	-
Net deferred income tax asset	$ 1,725,200	$ 1,265,200

The tax benefit of net operating losses, temporary differences, and credit carryforwards are recorded as an asset to the extent that management assesses that realization is “more likely than not.” Realization of the future tax benefits is dependent on the Bank’s ability to generate sufficient taxable income within the carryforward period. During the year ended December 31, 2014, the valuation allowance decreased by approximately $387,800.

The Bank has usable net operating loss carryforwards of approximately $555,000 for federal tax purposes that begin to expire in 2019. The Tax Reform Act of 1986 and the California Conformity Act of 1987 imposes substantial restrictions on the utilization of net operating loss carryforwards when an “ownership change,” as defined in the Internal Revenue Code, has occurred. Some of the Bank’s federal and state net operating losses have each been limited to usage of approximately $71,500 annually due to ownership changes.

NOTE 10 – COMMITMENTS AND CONTINGENCIES

Lease commitments – The Bank leases certain facilities where it conducts its operations on a month-to-month basis. The Bank has entered into term leases for its Danville, San Mateo, and Oakland locations. The Bank is responsible for common area maintenance, taxes, and insurance to the extent these exceed the base year amounts. The leases expire between October 2017 and November 2019. During 2014, the Bank entered into a month-to-month lease agreement with a related party for their Campbell loan production office. The Bank has determined that these lease terms are similar to those that would be available from a third party.

During 2014, the Bank moved their Danville branch to a new location in Danville. The Bank is sub-leasing the previous Danville location under an operating lease agreement. The lease expires in October 2017. Total rental income, offsetting rent expense, amounted to $85,112 and $18,892 at December 31, 2015 and December 31, 2014, respectively.

At December 31, 2015, the future minimum rental payments and income under non-cancelable operating leases are as follows:

	PAYMENTS	INCOME
2016	$ 647,430	$ (95,915)
2017	649,183	(82,689)
2018	508,127	-
2019	259,578	-
	$ 2,064,318	$ (178,604)

The minimum rental payments shown above are given for the existing lease obligations and are not a forecast of future rental expense. The Bank recognized rent expense of $573,755 and $434,039 for the years ended December 31, 2015 and 2014, respectively, net of sublease income.

Financial instruments with off-balance-sheet risk – The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business in order to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments consist of commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheets.

The Bank's exposure to credit loss in the event of non-performance 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. The Bank uses the same credit policies in making commitments and standby letters of credit as it does for loans included on the balance sheets.

At December 31, 2015 and 2014, the Bank had commitments to extend credit of approximately $24,785,553 and $20,155,636, respectively. There were $2,035,775 and $2,062,375 in standby letters of credit issued at December 31, 2015 and 2014, respectively.

NOTE 10 – COMMITMENTS AND CONTINGENCIES (CONTINUED)

Financial instruments with off-balance-sheet risk (continued) – Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies, but may include accounts receivable, inventory, and deeds of trust on residential real estate and income-producing commercial properties.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance or financial obligation of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers.

Contingencies – The Bank is subject to legal proceedings and claims that arise in the ordinary course of business. In the opinion of management, the amount of ultimate liability with respect to such actions will not materially affect the financial position or results of operations of the Bank.

NOTE 11 – SHAREHOLDERS' EQUITY

Preferred stock – In January 2009, the Bank issued 1,747 shares of Series A, fixed rate non-cumulative perpetual preferred stock to the U.S. Treasury as part of the Treasury's Capital Purchase Program (CPP). The non-cumulative preferred stock is carried at liquidation value of $1,000 per share and must be redeemed after ten years and carries a fixed dividend rate of 5% with dividends payable quarterly. In September 2010, the Bank redeemed 1,747 shares of Series A preferred stock and issued 4,060 shares of Series A-1, fixed rate non-cumulative preferred stock issued as part of the Treasury's Community Development Capital Initiative (CDCI). The newly issued shares carry an initial fixed dividend rate of 2% increasing to 9% after eight years, with dividends payable quarterly. The Bank paid dividends totaling $81,200 during the years ended December 31, 2015 and 2014, after receiving approval from the Department of Business Oversight (DBO) and their shareholders.

Dividend restrictions – Upon declaration by the Board of Directors, all shareholders of record will be entitled to receive dividends. The California Financial Code provides that, unless the Bank receives prior approval from the California Commissioner of Financial Institutions, the total amount of dividend payments a California state-chartered bank can make in any calendar year cannot exceed the lesser of: (1) the Bank's retained earnings or (2) the Bank's net income for its last three fiscal years, less distributions made to shareholders during the same three-year period. At December 31, 2015 and 2014, the Bank had an accumulated deficit. Therefore, no amount is available for dividends to shareholders. As discussed above, the Bank received approval from the DBO and their shareholders to make dividend payments on the Series A-1 and Series A preferred stock during 2015 and 2014.

NOTE 11 – SHAREHOLDERS' EQUITY (CONTINUED)

Earnings (loss) per share – Earnings (loss) per share (EPS) is calculated based on the weighted average common shares outstanding during the period. Basic EPS excludes dilution and is calculated by dividing net income available to common shareholders by the weighted average common shares outstanding. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock.

	YEAR ENDED DECEMBER 31, 2015		
	Income (Numerator)	Shares (Denominator)	Per-Share Amount
Basic EPS:			
Net income available to common shareholders	$ 1,251,697	4,232,435	$ 0.30
Effect of dilutive securities:			
Stock options	-	185,252	
Diluted EPS:			
Net income available to common shareholders plus assumed conversions	$ 1,251,697	4,417,687	$ 0.28

	YEAR ENDED DECEMBER 31, 2014		
	Income (Numerator)	Shares (Denominator)	Per-Share Amount
Basic EPS:			
Net income available to common shareholders	$ 1,625,762	4,206,637	$ 0.39
Effect of dilutive securities:			
Stock options	-	118,513	
Diluted EPS:			
Net income available to common shareholders plus assumed conversions	$ 1,625,762	4,325,150	$ 0.38

NOTE 11 – SHAREHOLDERS' EQUITY (CONTINUED)

Stock option plan – The Bank's 2001 Stock Option Plan expired during 2011. The Bank has option grants still outstanding under that Plan. During 2012, the Board of Directors and shareholders approved the adoption of the Community Bank of the Bay 2012 Stock Option Plan. The plan includes both non-statutory stock options, which may be granted to directors, employees, and consultants, and incentive stock options, which may be granted to employees. The price of non-statutory and incentive stock options may not be less than 100%, respectively, of the fair market value of the common stock on the date of the grant.

However, if an individual at the time of the grant owns stock representing more than 10% of the voting rights of all classes of the stock, then the price of the stock options may not be less than 110% of the fair market value of the common stock on the date of the grant. The term of stock options is determined by the Board of Directors, but may not exceed ten years from the date of the grant unless, in the case of an incentive stock option, an individual at the time of grant owns stock representing more than 10% of the voting rights of all classes of the stock, then the maximum term is five years. As of December 31, 2015, 1,221,476 shares of the Bank's common stock are reserved under this plan.

The fair value of each option granted is estimated on the date of grant using the Black-Scholes options-pricing model with the following weighted-average assumptions used for grants in 2015 and 2014, respectively: no expected dividends; expected volatility between 54.43% and 54.53% in 2015 and between 54.71% and 59.6% in 2014; risk-free interest rates between 2.25% and 2.32% in 2015 and between 2.13% and 2.68% in 2014; and expected options term of ten years.

The following table summarizes information about stock options outstanding at December 31, 2015:

	Shares	Weighted Average Exercise Price
Outstanding at beginning of period	1,007,605	$ 3.55
Granted	20,500	$ 4.47
Exercised	(12,000)	$ 2.53
Forfeited / canceled	(40,217)	$ 3.14
Expired	(5,000)	$ 7.00
Outstanding at end of period	970,888	$ 3.58

NOTE 11 – SHAREHOLDERS' EQUITY (CONTINUED)

Stock option plan (continued) – The Bank recognized $331,713 and $181,672 in stock option expense for the years ended December 31, 2015 and 2014, respectively. There is approximately $585,552 and $841,941 in unrecognized compensation cost remaining as of December 31, 2015 and 2014, respectively, which is expected to be recognized over a weighted-average period of 3.50 years and 3.91 years, respectively. The Bank had 460,051 incentive stock options and 510,837 non-statutory stock options outstanding as of December 31, 2015. The Bank had 495,768 incentive stock options and 511,837 non-statutory stock options outstanding as of December 31, 2014.

A summary of options outstanding follows:

	YEAR ENDED DECEMBER 31,	
	2015	2014
Weighted-average fair value of options granted during the year	$ 2.93	$ 2.75
Intrinsic value of options exercised	$ 23,640	$ 18,200
Options exercisable at year end	690,813	575,758
Weighted-average exercise price	$ 3.40	$ 3.33
Intrinsic value	$ 1,370,350	$ 543,607
Weighted-average remaining contractual life	6.17 Years	6.75 Years
Options outstanding at year end	970,888	1,007,605
Weighted-average exercise price	$ 3.58	$ 3.55
Intrinsic value	$ 1,751,137	$ 733,701
Weighted-average remaining contractual life	6.84 Years	7.77 Years

NOTE 12 – REGULATORY MATTERS

The Bank is subject to various regulatory capital requirements administered by the FDIC. Failure to meet these minimum capital requirements can initiate certain mandatory – and possibly additional discretionary – actions by regulators that, if undertaken, could have a direct material effect on the Bank'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.

NOTE 12– REGULATORY MATTERS (CONTINUED)

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of total and Tier I capital to risk-weighted assets, and of Tier I capital to average assets. Each of these components is defined in the regulations. Management believes that the Bank met all capital adequacy requirements as of December 31, 2015 and 2014.

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 following table.

	Actual		For Capital Adequacy Purposes		To be well Capitalized under PCA	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2015:						
Common equity Tier 1 (to risk-weighted assets)	$ 18,300,000	8.20%	10,039,000	≥ 4.5%	14,500,000	≥ 6.5%
Total risk-based capital (to risk-weighted assets)	$ 25,158,000	11.28%	$ 17,846,000	≥ 8.0%	$ 22,308,000	≥ 10.0%
Tier I capital (to risk-weighted assets)	$ 22,360,000	10.02%	$ 8,923,000	≥ 4.0%	$ 13,385,000	≥ 6.0%
Tier I capital (to average assets)	$ 22,360,000	9.04%	$ 9,899,000	≥ 4.0%	$ 12,373,000	≥ 5.0%
December 31, 2014:						
Total risk-based capital (to risk-weighted assets)	$ 23,331,000	12.47%	$ 14,973,000	≥ 8.0%	$ 18,716,000	≥ 10.0%
Tier I capital (to risk-weighted assets)	$ 20,985,000	11.21%	$ 7,486,000	≥ 4.0%	$ 11,229,000	≥ 6.0%
Tier I capital (to average assets)	$ 20,985,000	10.76%	$ 7,805,000	≥ 4.0%	$ 9,756,000	≥ 5.0%

The Federal Reserve and the FDIC approved final capital rules in July 2013 that substantially amend the existing capital rules for banks. These new rules reflect, in part, certain standards initially adopted by the Basel Committee on Banking Supervision in December 2010 (which standards are commonly referred to as "Basel III") as well as requirements contemplated by the Dodd-Frank Act. Under the new capital rules, the Bank will be required to meet certain minimum capital requirements that differ from current capital requirements. The rules implement a new capital ratio of common equity Tier 1 capital to risk-weighted assets.

The prompt corrective action rules are modified to include the common equity Tier 1 capital ratio noted above and to increase the Tier 1 capital ratio requirements for the various existing thresholds. The rules also modify the manner in which certain capital elements are determined and make changes to the methods of calculating the risk-weighting of certain assets, which in turn affects the calculation of the risk-weighted capital ratios. Higher risk weights are assigned to various categories of assets. The Bank is required to comply with the new capital rules on January 1, 2015, with a measurement date of March 31, 2015. Certain calculations under the rules will also have phase-in periods.

NOTE 13 – GOVERNMENT GRANT

In 2015 and 2014, the Bank was awarded $265,496 and $355,000, respectively, by the United States Treasury Department in recognition of its community development activities under the Bank Enterprise Award Program (the BEA). Management believes that the Bank has complied, in all material aspects, with all of the covenants and requirements under the BEA agreement and that it is not, and has not been, in default with any of the terms, requirements, or minimum levels of qualified activities of such agreement.

NOTE 14 – OTHER EXPENSES

Other expenses consisted of the following:

	DECEMBER 31,	
	2015	2014
Professional fees	$ 582,928	$ 443,042
Advertising	136,405	128,018
Data processing	391,413	376,348
Regulatory assessments	211,319	241,582
Insurance	75,558	68,009
Other operating expenses	746,052	666,640
Total	$ 2,143,675	$ 1,923,639

NOTE 15 – EMPLOYEE BENEFITS

Defined contribution plan – The Bank adopted a 401(k) defined contribution plan effective January 1, 1997. All employees of the Bank may participate in the plan upon completion of certain eligibility requirements. The Bank matches employee's contributions on a discretionary basis. There were no discretionary contributions for the years ended December 31, 2015 and 2014.

NOTE 16 – DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair values of financial instruments are management's estimates of the values at which instruments could be exchanged in a transaction between willing parties. These estimates are subjective and may vary significantly from amounts that would be realized in actual transactions. Further, the tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on the fair value estimates and have not been considered in any of these estimates.

The estimated fair values of the Bank's financial instruments as of December 31 are approximately as follows:

		2015		2014	
	Fair Value Hierarchy	Carrying Amounts	Estimated Fair Values	Carrying Amounts	Estimated Fair Values
Financial assets:					
Cash and cash equivalents	Level 1	$ 18,175,916	$ 18,175,916	$ 24,283,131	$ 24,283,131
Interest bearing deposits in banks	Level 2	14,412,000	14,205,084	12,893,000	12,865,778
Securities available-for-sale	Level 2	3,819,462	3,819,462	7,164,184	7,164,184
FHLB stock	Level 2	833,300	833,300	656,500	656,500
Loans, net	Level 3	196,701,570	196,955,000	172,314,576	178,633,000
Interest receivable	Level 2	566,308	566,308	550,800	550,800
Financial liabilities:					
Non-maturity deposits	Level 2	158,467,279	158,467,279	138,542,288	138,542,288
Time deposits	Level 2	59,502,603	59,793,000	60,278,834	60,500,000
FHLB borrowings	Level 2	-	-	3,999,388	39,999,388
Interest payable	Level 2	36,104	36,104	32,138	32,138
Off-balance-sheet liabilities:					
Undisbursed loan commitments	Level 3	-	248,000	-	202,000

The Bank utilizes fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. The Bank groups assets and liabilities at fair value in a three-level valuation hierarchy for disclosure of fair value measurement. The valuation hierarchy is based on the transparency of inputs to the valuation of an asset or liability as of the measurement date.

In general, fair values determined by Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that the Bank 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.

NOTE 16 – DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

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 Bank'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. Some fair value measurements, such as available-for-sale securities, are performed on a recurring basis, while others such as other real estate owned and impaired loans are performed on a non-recurring basis.

The following table presents information about the Bank's assets and liabilities measured at fair value on a recurring basis as of December 31, 2015 and 2014, as well as assets and liabilities for which a non-recurring change in the fair value has been recorded as of December 31, 2015 and 2014. The table indicates the fair value hierarchy of the valuation techniques utilized by the Bank to determine such fair value.

Description of Assets	December 31, 2015	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Available-for-sale securities:				
Municipal securities (taxable)	$ 636,828	$ -	$ 636,828	$ -
Municipal securities (non-taxable)	-	-	-	-
Agency	487,140	-	487,140	-
Mortgage-backed securities	1,466,449	-	1,466,449	-
CMOs	927,707	-	927,707	-
Corporates	301,338	-	301,338	-
Total	$ 3,819,462	$ -	$ 3,819,462	$ -

Description of Assets	December 31, 2014	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Available-for-sale securities:				
Municipal securities (taxable)	$ 985,689	$ -	$ 985,689	$ -
Municipal securities (non-taxable)	513,085	-	513,085	-
Agency	483,190	-	483,190	-
Mortgage-backed securities	1,964,885	-	1,964,885	-
CMOs	2,559,201	-	2,559,201	-
Corporates	658,134	-	658,134	-
Total	$ 7,164,184	$ -	$ 7,164,184	$ -

NOTE 16 – DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

Transfers between levels in the fair value hierarchy are recognized on the actual date of the event or circumstances that caused the transfer, which generally corresponds to the Bank's quarterly valuation process.

Fair value measurements for impaired loans are based on either collateral values supported by appraisals or observed market prices. Any loss recognized on impaired loans is not recorded directly as an adjustment to current earnings but rather as an adjustment component in determining the overall adequacy of the allowance for loan losses. Such adjustments to the estimated fair value of impaired loans may result in increases or decreases to the provision for loan losses recorded in current earnings.

The following methods and assumptions were used to estimate the fair value of each class of financial instrument for which it is practicable to estimate that value:

Cash and cash equivalents – For short-term instruments, including cash and due from banks, the carrying amount is a reasonable estimate of fair value.

Interest-bearing deposits in banks – Represents time deposits held at other financial institutions. The fair values are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities.

Securities – Fair values for investment securities are based on quoted market prices when available or through the use of alternative approaches, such as a matrix or model pricing, when market quotes are not readily accessible or available.

FHLB stock and other investments – For FHLB stock and other investments, the carrying amount is a reasonable estimate of fair value.

Loans – For variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. The fair values for fixed rate loans are estimated using discounted cash flow analysis, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. The carrying amount of interest receivable approximates its fair value. The Bank's allowance for loan and lease losses is a reasonable estimate of the valuation allowance needed to adjust computed fair values for the quality of certain loans in the portfolio.

Interest receivable and payable – For interest receivable and payable, the carrying amount is estimated to be the fair value.

Impaired loans – The Bank utilizes current appraisals and applies discount factors estimated and modeled for consistency by management to arrive at the estimate of fair value for all collateral dependent loans.

Other real estate owned – The Bank utilizes current appraisals discounted for estimated selling costs to arrive at the estimate of fair value for all other real estate owned.

NOTE 16 – DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

Deposit liabilities – The fair values disclosed for non-maturity deposits (e.g., interest and non-interest checking, statement savings, and money market accounts) are, by definition, equal to the amount payable at the reporting date (i.e., their carrying amounts). The fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits. The carrying amount of interest payable approximates its fair value.

FHLB borrowings – The fair value of the borrowings is calculated based on the discounted value of the contractual cash flows using current rates at which such borrowings can currently be obtained.

Secured borrowings – The fair value approximates book value as they represent short-term borrowings connected to the sale of loans.

Commitments to extend credit – The fair value of commitments is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates.

Limitations – Fair value estimates are made at a specific point in time, based on relevant market information and other information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Bank's entire holdings of a particular financial instrument.

NOTE 17 – SUMMARY OF QUARTERLY RESULTS OF OPERATIONS (UNAUDITED)

The following table sets forth summarized data for the year pertaining to each quarter for 2015 and is unaudited:

	2015 Quarter Ended			
	December 31	September 30	June 30	March 31
Total assets	$ 240,551,748	$ 255,966,378	$ 253,241,915	$ 239,150,586
Gross loans	197,796,106	191,736,113	179,479,941	176,989,247
Deposits	217,969,882	232,640,142	226,786,006	212,883,956
Net interest income	2,428,418	2,417,962	2,458,820	2,346,890
Net income	87,368	446,437	340,221	458,871

NOTE 18 – SUBSEQUENT EVENTS

The Bank has evaluated the effects of subsequent events that have occurred after the period ending December 31, 2015 and through June 9, 2016, which is the date the financial statements were issued.

SOCIAL IMPACT REPORT 2015

The mission of Community Bank of the Bay is to make a positive and sustainable economic impact on our community by providing local businesses and non-profit organizations a committed and resourceful financial partner who can help them achieve their goals and build a healthy and economically inclusive community.

Community Bank of the Bay gave to 54 local non-profit organizations for a total of $102,110 in 2015.

Alameda County Meals on Wheels
Arundel Parent Teachers Association
Beyond Emancipation
Capes 4 Heroes
Center for Elders Independence
City of Oakland Mayors City Job Program
Coaching for Social Change
Collaborating Agencies Responding to Disasters
College is Real INC
College of San Mateo
Commercial Real Estate Women Silicon Valley
Danville Area Chamber of Commerce College Scholarship Fund
Danville Sycamore Valley
Disability Rights Advocates (DRA)
Diablo Ballet
Discovery Counseling Center
Dublin Chamber of Commerce
East Bay Asian
Local Development Corporation

Financial Aptitude Training (FiAT)
Harbor House Ministries, INC
Heartland Media Foundation
Throw Like a Girl
Housing Economic Rights Advocates (Hera)
Inner City Advisors
Marine Applied Research & Exploration
Mindblown Labs
Oakland Art Murmur
Oakland Children's Fairyland
Oakland Community Organizations
Oakland Jobs & Housing Coalition
Oakland Makers
Oakland Rotary Endowment
Peninsula Parents & Friends
of San Mateo County
Police and Fire Fallen Heroes
Professional Fiduciary Association of California
Renaissance Entrepreneurship Center
Rock Paper Scissors Collective
Rose Foundation for Communities

Rotary Club of Danville
Rotary Club of San Ramon
Rotary of San Mateo
San Francisco Fire Fighter Toy Program
San Jose Silicon Valley Community Education Foundation
San Mateo County PRIDE Festival
San Mateo on Ice
San Ramon Chamber of Commerce
San Ramon Valley Education Foundation
Special Haven
Summit Bank Foundation
Sustainable San Mateo County
Sustainable Silicon Valley
The Hidden Genius Project
The Intero Foundation
Upswing Aerial Dance
Vintage High Boys Basketball Booster
Wardrobe for Opportunity
Wild & Scenic Film Festival
Youth Radio

SERVING OUR COMMUNITY

Community Bank of the Bay works hard to fulfill its mission of making a positive and sustainable impact on its community. CBB Employees are offered paid time off for volunteering. Our Directors, Executives and Officers dedicate many hours to worthwhile service organizations throughout the year, helping local business groups, neighborhood improvement councils and youth and family organizations.

Service Organizations & Non-Profits

City of San Ramon Economic
Development Advisory Committee
College is Real
Danville Bandits Basketball Club
Harambee Community Services
Inner City Advisors
Institute for the Future
Oakland First Fridays Festival
Oakland Jobs and Housing Coalition
Oakland Makers

Rotary Club of Oakland
Rotary Club of Danville Sycamore Valley
Rotary Club of San Jose
Rotary Club of San Ramon
San Mateo Area Rotary Club
San Ramon Valley Educational Roundtable
St. John of Arc CYO
Sundance Institute
The 100 Club
The Children's Place Pre-School
United Way Silicon Valley

Disability Rights Advocates
Oakland Chamber of Commerce
Walnut Creek Chamber of Commerce
Danville Chamber of Commerce
Dublin Chamber of Commerce
San Jose Silicon Valley Chamber of Commerce
San Mateo Area Chamber of Commerce
San Ramon Chamber of Commerce
Leadership San Ramon Valley Alumni
Leadership San Mateo Area

CDFI DATA

- CDFI Deposits: $8,187,645
- CDFI Qualified Loans for Bank Enterprise Award: $14,866,300
- CDFI Investments: $1,100,000

BEA Award Recipient 2015

Community Bank of the Bay received the maximum award amount of $265,496.

Community Bank of the Bay has been selected to receive an award through the FY 2015 round of the Bank Enterprise Award Program for supporting CDFI-Related Activities by creating CDFI deposits/shares with CDFI partners Bethex Federal Credit Union in Bronx, New York; Syracuse Cooperative Federal Credit Union in Syracuse, New York; Latino Community Credit Union in Durham, North Carolina; Brewery Credit Union in Milwaukee, Wisconsin; Communicating Arts Credit Union in Detroit, Michigan; Hope Federal Credit Union in Jackson, Mississippi; Northeast Community Federal Credit Union in San Francisco, California; and Lower East Side People's Federal Credit Union in New York, New York; and by providing community development and economic development projects in qualified Distressed Communities in San Francisco, Oakland, Berkeley, California, and in Moses Lake, Washington, by providing commercial real estate loans and project investments and small business loans and project investments. Community Bank of the Bay is a certified CDFI and a state-chartered bank.

CBB works closely with the California Capital Access Program, Inner City Advisors, Pacific Community Ventures, Working Solutions, Cutting Edge Capital, and the Alameda County Small Business Development Center to help fund loans to businesses that might not otherwise qualify for traditional credit.

Financial Literacy

The Bank invests in creative solutions to big problems, such as sponsoring a fun, mobile game that teaches financial literacy called Thrive n' Shine.

Impact Metrics (Dec. '14 – Dec. '15)

- 688 Players of the game
- 10,421 Completed Financial Capability Challenges
- 12,663 In-Game Visits to Community Bank of the Bay

BAY AREA GREEN FUND

IMPACT DATA

- BAGF deposits: $11,890,388
- CDARS, Green deposits: $12,535,879
- BAGF Loans: $15,938,390

Bay Area Green Fund is a unique program that allows environmentally conscious depositors to direct their funds to environmentally sustainable projects and businesses.

"The mission of the Bay Area Green Fund is to reduce emissions and protect natural resources by offering FDIC-insured bank accounts that support financing of environmentally sustainable projects and businesses."

Emissions Water Food Energy Waste

IMPACT REPORT

"Impact investing" is most commonly described as the strategic placement of resources with the intent of generating both financial and non-financial returns. CBB proposes that anyone can become an Impact Investor by moving their FDIC-insured bank accounts into a mission-driven program like the Bay Area Green Fund (BAGF). In fact, it's likely one of the most accessible, affordable and effective ways there is to support local "green" businesses and projects.

Conceptualized in 2007, the BAGF has a focused strategic plan, strict eligibility criteria, and an objective Advisory Committee. This report reflects the program's progress over the last year so Impact Investors can better understand the environmentally sustainable benefits that are being financed through the BAGF. Feedback and recommendations are welcome so CBB can ensure the quality and usefulness of the BAGF reporting.

BAY AREA GREEN FUND ADVISORY BOARD

Debbie Beyea
Deputy Director
Ecology Center

Lauryn Agnew
President
Seal Cove Financial

Ron Elvidge
Venture Capitalist

Ryan Gardner
MESM, LEED AP, ENV SP
Sustainability Associate
Rincon Consultants

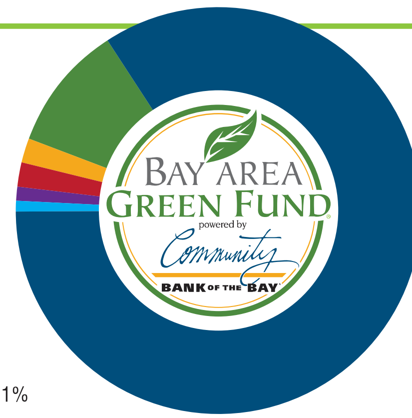
Steven H. Smith
Senior Environmental Planner
City and County of San Francisco

BAGF HIGHLIGHTS

REGIONAL BAGF ACCOUNT PRODUCTION

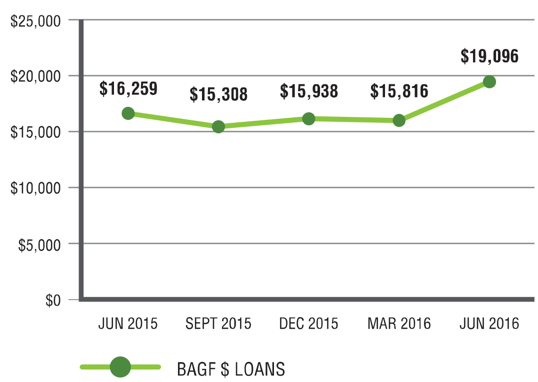
DEPOSITS ($) :	$24,300,000
ACCOUNTS (#) :	147
LOANS ($) :	$19,100,000
LOANS (#) :	25

- EAST BAY, 84%
- SOUTH BAY, 10%
- OTHER, 2%
- PENINSULA, 2%
- NORTH BAY, 1%
- SAN FRANCISCO, 1%

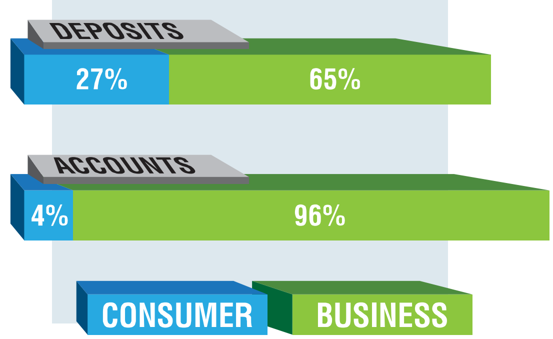


The more depositors elect to participate by bringing their FDIC-insured accounts to CBB, the more money CBB can lend to local "green" businesses and non-profits.

BAGF $ LOANS



BAGF DEPOSIT & ACCOUNTS
BUSINESS VS. CONSUMER



To uphold the program's integrity and ensure only sustainable financing is included in the BAGF's impact reporting, an independent Advisory Committee (staffed by objective experts) periodically convenes to determine which of CBB's credit-approved projects and/or businesses are eligible.

www.bankcbb.com/bayareagreenfund

SBA PREFERRED LENDER · EQUAL HOUSING LENDER · Member FDIC · Proud to be the first CDFI certified bank in California

CBB was founded and is headquartered in Oakland with offices in Danville, San Mateo and the South Bay

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