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INDEPENDENT AUDITOR'S REPORT

The Shareholders and
Board of Directors
Redwood Capital Bancorp and Subsidiary
Eureka, California

We have audited the accompanying consolidated balance sheets of Redwood Capital Bancorp (the Company) and its wholly-owned subsidiary, Redwood Capital Bank as of December 31, 2009 and 2008, and the related consolidated statements of operations, changes in shareholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Redwood Capital Bancorp and its wholly-owned subsidiary, Redwood Capital Bank as of December 31, 2009 and 2008, and the consolidated results of its operations and its consolidated cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Richardson & Company

March 29 2010

REDWOOD CAPITAL BANCORP
AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

December 31, 2009 and 2008

	2009	2008
ASSETS		
Cash and due from banks	$ 3,472,096	$ 5,582,425
Federal funds sold	22,450,000	9,615,000
Cash and cash equivalents	25,922,096	15,197,425
Investment securities available-for-sale, at fair value	15,951,348	10,253,071
Loans, net	134,209,255	127,841,123
Premises and equipment, net	4,368,887	4,501,067
Foreclosed real estate	326,379	
Cash surrender value of life insurance	2,398,504	2,298,540
Accrued interest receivable and other assets	3,124,079	1,689,142
TOTAL ASSETS	$ 186,300,548	$ 161,780,368
LIABILITIES AND SHAREHOLDERS' EQUITY		
LIABILITIES		
Deposits		
Non interest-bearing	$ 24,943,739	$ 25,725,450
Interest-bearing	144,182,414	121,710,568
Total deposits	169,126,153	147,436,018
Other borrowings	1,500,250	3,000,000
Accrued interest payable and other liabilities	629,329	512,227
TOTAL LIABILITIES	171,255,732	150,948,245
Commitments and contingencies (see accompanying notes)		
SHAREHOLDERS' EQUITY		
Preferred stock, Series A and B, no par value; 10,000,000 shares authorized; 3,800 shares of Series A and 190 shares of Series B issued and outstanding in 2009	3,824,214	
Common stock, no par value; 30,000,000 shares authorized; 1,733,034 and 1,728,494 shares issued and outstanding in 2009 and 2008	11,699,908	11,611,403
Additional paid-in capital	562,054	455,759
Accumulated deficit	(1,300,755)	(1,502,338)
Accumulated other comprehensive income	259,395	267,299
TOTAL SHAREHOLDERS' EQUITY	15,044,816	10,832,123
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 186,300,548	$ 161,780,368

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

REDWOOD CAPITAL BANCORP
AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF OPERATIONS

For the Years Ended December 31, 2009 and 2008

	2009	2008
INTEREST INCOME		
Interest and fees on loans	$ 8,273,211	$ 7,926,021
Interest on taxable investment securities	502,208	475,560
Dividend income	6,404	31,740
Interest on federal funds sold	39,485	85,284
Interest on deposits in banks	9,178	77,318
Total interest income	8,830,486	8,595,923
INTEREST EXPENSE		
Interest on deposits	2,183,150	2,741,192
Interest on other borrowings	25,338	117,028
Total interest expense	2,208,488	2,858,220
NET INTEREST INCOME	6,621,998	5,737,703
Provision for loan losses	1,558,000	1,523,500
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	5,063,998	4,214,203
OTHER INCOME		
Service charges and fees	450,569	404,927
Other income	575,996	441,345
Total other income	1,026,565	846,272
OTHER EXPENSES		
Salaries and employee benefits	2,566,146	2,333,522
Foreclosed real estate	589,078	
Occupancy and equipment	573,373	577,863
Other	1,934,690	1,954,133
Total other expenses	5,663,287	4,865,518
Income before provision for income taxes	427,276	194,957
Provision for income taxes	1,600	1,600
NET INCOME	$ 425,676	$ 193,357
NET INCOME PER SHARE	$ 0.25	$ 0.11
NET INCOME PER SHARE – ASSUMING DILUTION	$ 0.24	$ 0.11

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

REDWOOD CAPITAL BANCORP
AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

For the Years Ended December 31, 2009 and 2008

	Comprehensive Income	Preferred Stock	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive (Loss) Income	Total Shareholders' Equity
Balance at January 1, 2008			1,680,486	$ 11,211,107	$ 393,890	$ (1,695,695)	$ 41,130	$ 9,950,432
Stock options exercised			46,358	379,671	(70,464)			309,207
Stock option and restricted stock expense					152,958			152,958
Restricted stock vested			1,650	20,625	(20,625)			
Comprehensive income:								
Net income	$ 193,357					193,357		193,357
Other comprehensive income: Unrealized holding gains on securities available-for-sale arising during the year	226,169						226,169	226,169
Total comprehensive income	$ 419,526							
Balance at December 31, 2008			1,728,494	11,611,403	455,759	(1,502,338)	267,299	10,832,123
2009 activity:								
Preferred stock issuance		$ 3,789,388						3,789,388
Dividends on preferred stock						(189,267)		(189,267)
Amortization/Accretion of preferred stock, net		34,826				(34,826)		
Stock options exercised			840	6,880	(1,277)			5,603
Stock option and restricted stock expense					152,797			152,797
Restricted stock vested			3,700	81,625	(45,225)			36,400
Comprehensive income:								
Net income	$ 425,676					425,676		425,676
Other comprehensive income: Unrealized holding losses on securities available-for-sale arising during the year	(7,904)						(7,904)	(7,904)
Total comprehensive income	$ 417,772							
BALANCE AT DECEMBER 31, 2009		$ 3,824,214	1,733,034	$ 11,699,908	$ 562,054	$ (1,300,755)	$ 259,395	$ 15,044,816

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

REDWOOD CAPITAL BANCORP
AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Years Ended December 31, 2009 and 2008

	2009	2008
OPERATING ACTIVITIES		
Net income	$ 425,676	$ 193,357
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	1,558,000	1,523,500
Deferred loan origination fees and costs, net	(62,493)	(119,148)
Realized loss on sale of foreclosed real estate	156,912	
Provision for losses on foreclosed real estate	439,050	
Depreciation and amortization	275,064	304,938
Stock-based compensation expense	152,797	152,958
Restricted stock awarded	36,400	
Net increase in cash surrender value of life insurance	(99,964)	(104,912)
Net change in accrued interest receivable and other assets	(1,291,137)	209,193
Net change in accrued interest payable and other liabilities	99,944	(109,850)
NET CASH PROVIDED BY OPERATING ACTIVITIES	1,690,249	2,050,036
INVESTING ACTIVITIES		
Purchase of available-for-sale investment securities	(11,117,030)	(2,963,183)
Proceeds from maturity of available-for-sale investment securities	3,025,000	1,000,000
Proceeds from paydowns on mortgage-backed securities	2,414,082	1,242,572
Proceeds from sale of foreclosed real estate	918,107	
Purchase of Federal Home Loan Bank stock	(143,800)	(111,400)
Net increase in loans	(9,704,087)	(26,404,956)
Purchases of premises and equipment	(171,117)	(9,039)
NET CASH USED BY INVESTING ACTIVITIES	(14,778,845)	(27,246,006)
FINANCING ACTIVITIES		
Net increase in deposits	21,690,135	30,605,353
Proceeds from exercise of stock options	5,603	309,207
Proceeds from other borrowings	1,500,250	1,685,000
Repayments of other borrowings	(3,000,000)	
Proceeds from the issuance of preferred stock	3,789,388	
Dividends paid on preferred stock	(172,109)	
NET CASH PROVIDED BY FINANCING ACTIVITIES	23,813,267	32,599,560
INCREASE IN CASH AND CASH EQUIVALENTS	10,724,671	7,403,590
Cash and cash equivalents at beginning of year	15,197,425	7,793,835
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 25,922,096	$ 15,197,425
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid during the year for:		
Interest	$ 2,239,089	$ 2,944,270
Income taxes	$ 281,600	$ 116,600
SUPPLEMENTAL DISCLOSURES OF NONCASH ACTIVITIES		
Net change in unrealized gains/losses on available-for-sale investment securities	$ (7,904)	$ 226,169
Loans transferred to foreclosed real estate	$ 1,840,448	

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

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Business: Redwood Capital Bancorp (the Company), formed in 2007, is a bank holding company whose principal activity is the ownership and management of its wholly-owned subsidiary, Redwood Capital Bank (the Bank). The Bank was incorporated on November 3, 2003 and commenced operations on March 24, 2004. The Bank is subject to regulation, supervision, and regular examination by the California Department of Financial Institutions (CDFI) and the Federal Deposit Insurance Corporation (FDIC). The regulations of these agencies govern most aspects of the Bank's business.

The financial statements of the Company are prepared in conformity with generally accepted accounting principles and general practice within the banking industry. In June 2009, the Financial Accounting Standards Board (FASB) issued FASB Accounting Standards Codification (ASC) 105, *Generally Accepted Accounting Principles*, which establishes the FASB Accounting Standards Codification as the sole source of authoritative generally accepted accounting principles (GAAP). Pursuant to the provisions of FASB ASC 105, the Company has updated references to GAAP in its financial statements issued for the year ended December 31, 2009. The adoption of FASB ASC 105 did not impact the Company's financial position or results of operations. The following is a summary of the significant accounting and reporting policies used in preparing these financial statements.

Principles of Consolidation: The consolidated financial statements include the accounts of the Company and the Bank. All material intercompany accounts and transactions have been eliminated.

Nature of Operations: The Bank provides commercial, industrial, agricultural and personal credit and other banking services through its branches located in Eureka and Fortuna, California.

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

The determination of the adequacy of the allowance for loan losses is based on estimates that are particularly susceptible to significant changes in the economic environment and market conditions. In connection with the determination of the estimated losses on loans, management obtains independent appraisals for significant collateral. The Company's loans are generally secured by specific items of collateral including real property, consumer assets, and business assets. Although the Company has a diversified loan portfolio, a substantial portion of its debtors' ability to honor their contracts is dependent on local economic conditions. While management uses available information to recognize losses on loans, further reductions in the carrying amounts of loans may be necessary based on changes in local economic conditions. Because of these factors, it is reasonably possible that the estimated losses on loans may change materially in the near term. However, the amount of the change that is reasonably possible cannot be estimated.

Investment Securities: Securities are classified as held-to-maturity if the Company has both the intent and ability to hold those debt securities to maturity regardless of changes in market conditions, liquidity needs or changes in general economic conditions. These securities are carried at cost, adjusted for amortization of premium and accretion of discount, computed by the interest method over their contractual lives.

Securities are classified as available-for-sale if the Company intends to hold those debt securities for an indefinite period of time, but not necessarily to maturity. Any decision to sell a security classified as available-for-sale would be based on various factors, including significant movements in interest rates, changes in the maturity mix of the Company's assets and liabilities, liquidity needs, regulatory capital considerations and other similar factors. Securities held as available-for-sale are carried at fair value. Unrealized holding gains or losses are reported as increases or decreases in shareholders' equity, net of the related deferred tax effect. Realized gains or losses, determined on the basis of the cost of specific securities sold, are included in earnings.

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Loans: Loans are stated at the amount of unpaid principal reduced by net deferred loan fees. Loan origination fees, net of direct origination costs, are deferred and recognized as an adjustment of the yield on the related loan. Amortization of net deferred loan fees is discontinued when the loan is placed on nonaccrual status. Interest on loans is accrued and credited to income based on the principal amount outstanding.

Allowance for Loan Losses: The allowance is maintained at a level which, in the opinion of management, is adequate to absorb probable losses inherent in the loan portfolio. Credit losses related to off-balance-sheet instruments are included in the allowance for loan losses. Management determines the adequacy of the allowance based upon reviews of individual loans, recent loss experience, current economic conditions, the risk characteristics of the various categories of loans and other pertinent factors. The allowance is based on estimates, and ultimate losses may vary from the current estimates. These estimates are reviewed monthly and, as adjustments become necessary, they are reported in earnings in the periods in which they become known. Loans deemed uncollectible are charged to the allowance. Provisions for loan losses and recoveries on loans previously charged off are added to the allowance.

All loans, except those to individuals, are considered impaired, based on current information and events, if it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Allowances on impaired loans are established based on the present value of expected future cash flows discounted at the loan's historical effective interest rate or, for collateral-dependent loans, on the fair value of the collateral. Cash receipts on impaired loans are used to reduce principal.

Income Recognition on Impaired and Nonaccrual Loans: Loans, including those considered impaired, are generally classified as nonaccrual if they are past due as to maturity or payment of principal or interest for a period of more than 90 days, unless such loans are well-secured and in the process of collection. If a loan or a portion of a loan is classified as doubtful or is partially charged off, the loan is classified as nonaccrual. Loans that are on a current payment status or past due less than 90 days may also be classified as nonaccrual if repayment in full of principal and/or interest is in doubt.

Loans may be returned to accrual status when all principal and interest amounts contractually due (including arrearages) are reasonably assured of repayment within an acceptable period of time, and there is a sustained period of repayment performance by the borrower, in accordance with the contractual terms of interest and principal.

While a loan is classified as nonaccrual and the future collectibility of the recorded balance is doubtful, collections of interest and principal are generally applied as a reduction to the principal outstanding. When the future collectibility of the recorded balance is expected, interest income may be recognized on a cash basis. In the case where a nonaccrual loan had been partially charged off, recognition of interest on a cash basis is limited to that which would have been recognized on the recorded balance at the contractual interest rate. Cash interest receipts in excess of that amount are recorded as recoveries to the allowance for loan losses until prior charge-offs have been fully recovered.

Premises and Equipment: Premises and equipment are stated at cost, less accumulated depreciation and amortization. The provision for depreciation and amortization is computed principally by the straight-line method over estimated useful lives of the related assets.

Foreclosed Real Estate: Foreclosed real estate includes both formally foreclosed property and in-substance foreclosed property. In-substance foreclosed properties are those properties for which the Company has taken physical possession, regardless of whether formal foreclosure proceedings have taken place. At the time of foreclosure, foreclosed real estate is recorded at the lower of the carrying amount or fair value less cost to sell, which becomes the property's new basis. Any write-downs based on the asset's fair value at date of acquisition are charged to the allowance for loan losses. After foreclosure, valuations are periodically performed by management and the real estate is carried at the lower of their new cost basis or fair value minus estimated costs to sell. Revenue and expenses from operations and subsequent adjustments to the carrying amount are included in other non-interest expenses.

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Investment in Federal Home Loan Bank Stock: As a member of the Federal Home Loan Bank (FHLB) System, the Bank is required to maintain an investment in capital stock of the FHLB. The investment exceeds the minimum requirement at December 31, 2009 and 2008. The investment is stated at cost in the accompanying balance sheets and is reported as part of other assets.

Income Taxes: Provisions for income taxes are based on amounts reported in the statements of operations (after exclusion of non-taxable income such as interest on state and municipal securities) and include deferred taxes on temporary differences in the recognition of income and expense for tax and financial statement purposes. Deferred taxes are computed using the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Deferred tax assets are recognized for deductible temporary differences and tax credit carryforwards, and then a valuation allowance is established to reduce that deferred tax asset if it is “more likely than not” that the related tax benefits may not be realized.

Net Income Per Share of Common Stock: Net income per share of common stock is computed by dividing net income by the weighted average number of shares of common stock outstanding during the year, after giving retroactive effect to stock dividends and splits. Net income per share – assuming dilution is computed similar to net income per share except that the denominator is increased to include the number of additional common shares that would have been outstanding if the dilutive potential common shares had been issued. Included in the denominator is the dilutive effect of stock options computed under the treasury method.

Advertising: Advertising costs are charged to operations in the year incurred.

Off-Balance-Sheet Financial Instruments: In the ordinary course of business the Company has entered into off-balance sheet financial instruments consisting of commitments to extend credit and standby letters of credit. Such financial instruments are recorded in the financial statements when they become payable.

Stock Option Accounting: The Company has a stock-based employee and director compensation plan which is described more fully in Note L. The Company applies the fair value recognition provisions of FASB ASC 718, *Accounting for Stock-Based Compensation*. Accordingly, compensation cost for stock options is measured based on the grant-date fair value and is recognized in the income statement. Awards under the Company’s plan generally vest over five years.

Operating Segments: Reportable segments are based on products and services, geography, legal structure, management structure and any other manner in which management desegregates a company for making operating decisions and assessing performance. The Company has determined that its business is comprised of a single operating segment.

Cash and Cash Equivalents: For the purpose of presentation in the Statement of Cash Flows, cash and cash equivalents are defined as those amounts included in the balance sheet caption “Cash and due from banks” and “Federal funds sold.”

Subsequent events: The Company evaluated all events or transactions that occurred after December 31, 2009 and up to March 29, 2010, the date the financial statements were issued. During this period, the Company did not have any recognizable or nonrecognizable subsequent events.

NOTE B – RESTRICTIONS ON CASH AND DUE FROM BANKS

Cash and due from banks include amounts the Company is required to maintain to meet certain average reserve requirements of the Federal Reserve Bank or the correspondent bank. The total requirement at both December 31, 2009 and 2008 was $50,000.

NOTE C – INVESTMENT SECURITIES

The amortized cost and approximate fair value of investment securities are summarized as follows:

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
December 31, 2009				
Securities Available-for-Sale				
U.S. government agency securities	$ 4,159,724	$ 33,806		$ 4,193,530
Mortgage-backed securities	3,332,309	179,737		3,512,046
Collateralized mortgage obligations	8,199,919	126,734	$ (80,881)	8,245,772
Total	$ 15,691,952	$ 340,277	$ (80,881)	$ 15,951,348
December 31, 2008				
Securities Available-for-Sale				
U.S. government agency securities	$ 3,025,000	$ 61,780		$ 3,086,780
Mortgage-backed securities	5,143,509	122,332	$ (180)	5,265,661
Collateralized mortgage obligations	1,817,215	83,415		1,900,630
Total	$ 9,985,724	$ 267,527	$ (180)	$ 10,253,071

The maturities of investment securities at December 31, 2009 were as follows:

	Available-for-Sale	
	Amortized Cost	Fair Value
Due from one year to five years	$ 665,524	$ 681,296
Due from five years to ten years	5,188,410	5,282,961
Due after ten years	9,838,018	9,987,091
	$ 15,691,952	$ 15,951,348

The amortized cost and fair value of mortgage-backed securities and collateralized mortgage obligations are presented by contractual maturity in the preceding table. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations without call or prepayment penalties.

Investment securities with an amortized cost of $5,745,304 and a fair value of $5,839,958 at December 31, 2009 were pledged to secure public deposits.

NOTE C – INVESTMENT SECURITIES (Continued)

The following table shows the investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2009 and 2008.

	2009		2008	
	Less than 12 Months		More than 12 Months	
Description of Securities	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Mortgage-backed securities			$ 287,077	$ (180)
Collateralized mortgage obligations	$ 4,306,047	$ (80,881)		
	$ 4,306,047	$ (80,881)	$ 287,077	$ (180)

There were three collateralized mortgage obligations that were in an unrealized loss position as of December 31, 2009. There was one mortgage-backed security that was in an unrealized loss position as of December 31, 2008. The unrealized losses on these securities were caused by interest rate increases. The contractual terms of these investments do not permit the issuer to settle the securities at a price less than the par value of the investment. Because the Company has the ability and intent to hold these investments until a recovery of fair value, which may be maturity, the Company does not consider these investments to be other-than-temporarily impaired at December 31, 2009 and 2008.

NOTE D – LOANS, NET

Major classifications of loans at December 31 are summarized as follows:

	2009	2008
Real estate – mortgage	$ 23,495,001	$ 19,480,293
Real estate – commercial	58,580,412	51,787,385
Construction loans	5,189,932	14,317,228
Commercial	21,997,703	22,507,012
Agricultural	429,254	233,671
Installment and other loans to individuals	26,989,921	21,124,888
	136,682,223	129,450,477
Net deferred loan fees and costs	(4,645)	(67,138)
Allowance for loan losses	(2,468,323)	(1,542,216)
	$ 134,209,255	$ 127,841,123

NOTE D – LOANS, NET (Continued)

Changes in the allowance for loan losses were as follows for the years ended December 31:

	2009	2008
Beginning balance	$ 1,542,216	$ 1,355,000
Provision for loan losses	1,558,000	1,523,500
Loans charged off	(653,071)	(1,321,284)
Loan recoveries	21,178	
Reclassification of reserve for undisbursed loan commitments		(15,000)
Ending balance	$ 2,468,323	$ 1,542,216

At December 31, 2009, the recorded investment in loans for which impairment has been recognized in accordance with FASB ASC 310 totaled $1,369,596. Included in this amount is $1,019,367 of impaired loans with a corresponding valuation allowance of $186,964 and $319,584 of impaired loans that, as a result of write-downs, do not have an allowance for losses. At December 31, 2008, the recorded investment in loans for which impairment has been recognized totaled $2,857,621, with a corresponding valuation allowance of $94,610. For the years ended December 31, 2009 and 2008, the average recorded investment in impaired loans was $2,192,746 and $1,642,490, respectively. During 2009 and 2008, $55,668 and $18,129 of interest was received and recognized on impaired loans, respectively.

At December 31, 2009, the Company has two nonaccrual loans totaling $371,324 for which impairment has not been recognized. At December 31, 2008, the Company has no other nonaccrual loans for which impairment had not been recognized. The Company has no commitments to loan additional funds to the borrowers of impaired or nonaccrual loans.

The Company receives fees for servicing retained on loans sold. Loans being serviced by the Company for others totaled approximately $4,089,445 and $5,768,646 for the years ended December 31, 2009 and 2008, respectively.

The maturity and repricing of the loan portfolio is as follows at December 31:

	2009	2008
Fixed rate loan maturities		
Three months or less	$ 1,033,526	$ 1,249,808
Over three months to twelve months	2,342,044	4,177,299
Over one year to five years	10,726,459	9,648,286
Over five years to fifteen years	5,879,919	7,807,910
Over fifteen years	1,780,803	1,784,369
Floating rate loans repricing		
Quarterly or more frequently	47,482,999	45,203,443
Quarterly to annual frequency	14,488,981	10,718,263
One to five years frequency	47,495,153	41,877,325
Five to fifteen years frequency	4,730,699	4,242,613
Non-accrual loans	721,640	2,741,161
	$ 136,682,223	$ 129,450,477

NOTE E – PREMISES AND EQUIPMENT

Premises and equipment consisted of the following at December 31:

	2009	2008
Land	$ 800,000	$ 800,000
Building and improvements	3,934,839	3,795,283
Furniture, fixtures and equipment	1,074,437	1,042,876
	5,809,276	5,638,159
Less: Accumulated depreciation	(1,440,389)	(1,137,092)
	$ 4,368,887	$ 4,501,067

Depreciation and amortization included in occupancy expense totaled $303,297 and $306,245 in 2009 and 2008, respectively.

NOTE F – INTEREST-BEARING DEPOSITS

Interest-bearing deposits consisted of the following at December 31:

	2009	2008
Negotiable order of withdrawal (NOW)	$ 38,188,848	$ 30,145,402
Savings and money markets	56,461,880	43,301,020
Time, $100,000 and over	19,074,828	18,492,346
Other time	30,456,858	29,771,800
	$ 144,182,414	$ 121,710,568

Interest expense on these deposits for the years ended December 31 is as follows:

	2009	2008
Negotiable order of withdrawal (NOW)	$ 440,526	$ 552,991
Savings and money markets	660,517	856,462
Time, $100,000 and over	468,930	580,838
Other time	613,177	750,901
	$ 2,183,150	$ 2,741,192

The maturities of time deposits at December 31 are as follows:

	2009	2008
Three months or less	$ 21,638,180	$ 28,454,874
Over three months through twelve months	24,022,415	16,379,530
Over one year through three years	3,545,911	2,852,768
Over three years	325,180	576,974
	$ 49,531,686	$ 48,264,146

NOTE G – LENDING AGREEMENTS

The Company has federal funds line of credit agreements with other banks. The maximum borrowings available under these lines amount to $9,000,000 at December 31, 2009 and 2008. There were no borrowings outstanding under these agreements at December 31, 2009 and 2008.

The Company has an agreement to borrow from the Federal Home Loan Bank to the extent of pledged assets, up to 15% of total assets. Assets pledged under the agreement at December 31, 2009 totaled $186,294,277, resulting in a limit on borrowings of $27,944,142. Assets pledged under the agreement at December 31, 2008 totaled $161,663,289, resulting in a limit on borrowings of $24,267,055. No amounts were outstanding under this agreement as of December 31, 2009 and 2008.

The Company has an agreement to borrow from the Federal Reserve Bank by obtaining advances or discounting eligible paper to the extent of pledged collateral. Promissory notes and deeds of trust on the Bank's loans totaling $6,881,607 were held by the Federal Reserve Bank as collateral. There were no borrowings outstanding under this agreement at December 31, 2009.

The Company has an agreement to borrow from another financial institution for $3,100,000. Interest on the outstanding balance is calculated at a variable rate equal to the prime rate. The interest rate at December 31, 2009 was 3.25%. Consecutive interest payments are required for 24 months beginning February 5, 2009 through February 5, 2011, after which principal and interest payments are due through January 5, 2021. The outstanding principal balance at December 31, 2009 was $1,500,250. The Company had another agreement to borrow at December 31, 2008 with an outstanding principal balance of $3,000,000, which was repaid during 2009. The interest rate at December 31, 2008 was 3.25%.

NOTE H – OTHER EXPENSES

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

	2009	2008
Data processing	$ 447,613	$ 416,204
Insurance expense	431,036	220,423
Professional fees	313,023	311,763
Operating expense	173,040	181,971
Marketing and promotion	148,257	205,366
Loan and collection expense	102,536	101,470
Director and shareholder	85,008	228,969
Stationary and forms	54,817	92,500
Postage and delivery	54,109	49,514
Telephone expense	48,483	51,634
Miscellaneous employee expense	33,990	34,093
Dues and memberships	31,181	40,724
Subscriptions	4,096	7,333
Operational losses	3,144	6,333
Security expense	3,256	3,809
Other non-interest expense	1,101	2,027
	$ 1,934,690	$ 1,954,133

NOTE H – PREFERRED STOCK

On January 16, 2009, the Company completed the issuance of $3,800,000 of Series A preferred stock and related warrant for Series B preferred stock under the U.S. Department of Treasury's Capital Purchase Program and issued 3,800 shares of Series A preferred stock and a warrant to acquire 190 shares of Series B preferred stock for the aggregate purchase price (collectively the "Preferred Stock"). The warrant was exercised immediately and the 190 shares issued. The Series A preferred stock has a cumulative dividend of 5% per annum for five years and, unless redeemed, 9% thereafter. The liquidation amount is $1,000 per share. The Series B preferred stock pay a dividend of 9%. The Preferred Stock has no maturity date and ranks senior to the Company's common stock with respect to the payment of dividends and distributions and amounts payable upon liquidation, dissolution and winding up of the Company. The Preferred Stock is generally non-voting, other than class voting on certain matters that could adversely affect the Preferred Stock. The Company paid preferred stock dividends of $189,267 in 2009.

NOTE I – RETIREMENT PLANS

The Company has a defined contribution retirement plan covering substantially all of the Company's employees. Employees may elect to have a portion of their compensation contributed to the plan in conformity with the requirements of Section 401(k) of the Internal Revenue Code. The Company will make contributions equal to 100% of the effective deferral made by the employees, up to a maximum of 4% of the employees' eligible earnings. Salaries and employee benefits expense includes the Company's contributions to the plan of $84,000 and $76,025 during 2009 and 2008, respectively.

The Company purchased single premium life insurance policies in 2006 in connection with the implementation of retirement plans for two key officers. The policies provide protection against the adverse financial effects from the death of key officers and to provide income to offset expenses associated with the plan. The officers are insured under the policies, but the Company is the owner and beneficiary. At December 31, 2009 and 2008, the cash surrender value of these policies totaled $2,398,504 and $2,298,540, respectively.

The Company has a retirement plan that is unfunded, which provides for the Company to pay the officers specified amounts for specified periods after retirement. If death occurs prior to or during retirement, the Company will pay the officer's beneficiary or estate the benefits set forth in the plan. Liabilities are recorded for the estimated present value of future salary continuation benefits. At December 31, 2009 and 2008, the liability recorded for the executive officer supplemental retirement plan totaled $94,718 and $59,213, respectively. The amount of expense related to this plan for 2009 and 2008 was $35,505 and $27,792, respectively.

NOTE J – INCOME TAXES

The provision for income taxes for 2008 consisted of $1,600 of current state income tax. The provision for income taxes for 2009 is comprised of the following:

Current	
Federal	$ 433,713
State	44,797
	478,510
Deferred	
Federal	(268,521)
State	(120,856)
	(389,377)
Change in valuation allowance	(87,533)
Provision for income taxes	$ 1,600

NOTE J – INCOME TAXES (Continued)

Income tax expense included in the statement of operations consisted of $1,600 of current state tax paid for the years ended December 31, 2009 and 2008. The following is a reconciliation of income taxes computed at the Federal statutory rate of 34% to the effective rate used for the provision for income taxes for the years ended December 31:

	2009	2008
Income benefit at the Federal statutory rate	$ 145,546	$ 66,285
State franchise tax benefit, less Federal income tax effect	30,626	13,948
Incentive stock option expense	2,183	19,525
Interest on enterprise zone loans exempt from State tax	(77,355)	(50,539)
Valuation allowance change	(87,533)	(123,958)
Earnings on cash surrender value of life insurance	(46,422)	(43,176)
Nondeductible expenses and other	34,555	119,515
Net provision for income taxes	$ 1,600	$ 1,600

The expected tax expense shown above that would result from applying Federal and State statutory rates to the pretax loss differs from amounts reported in the financial statements primarily because the valuation allowance increased to offset the impact of operating loss carryforwards and other temporary differences until such time as realization becomes more likely than not. The tax effects of temporary differences that give rise to the components of the net deferred tax assets as of December 31 were as follows:

	2009	2008
Deferred tax assets:		
Allowance for loan losses	$ 735,025	$ 341,371
Net operating loss carryforwards	170,196	314,294
Nonstatutory stock option expense	121,533	112,647
Deferred tax on AFS securities	106,752	110,005
Foreclosed real estate	101,672	
Non-qualified restricted stock	51,290	18,803
Salary continuation accrual	38,981	24,369
Allowance for loan commitments	24,693	20,577
Accrued vacation	13,534	13,534
Organizational costs	10,286	15,428
Enterprise zone credits	4,293	14,135
Non-accrual interest	1,233	72,931
Other	544	12,792
Total deferred tax assets	1,380,032	1,070,886
Valuation allowance for deferred tax assets	(811,011)	(898,544)
Deferred tax assets recognized	569,021	172,342
Deferred tax liabilities:		
Adjustment to cash basis	(48,895)	(110,014)
Federal Home Loan Bank dividends	(24,940)	(24,940)
Discount accretion	(9,912)	(8,560)
Depreciation	(6,764)	(28,828)
Total deferred tax liabilities	(90,511)	(172,342)
Net deferred tax assets	$ 478,510	$ -

NOTE J – INCOME TAXES (Continued)

Amounts presented for the tax effects of temporary differences are based upon estimates and assumptions and could vary from amounts ultimately reflected on the Company's tax returns. Accordingly, the variances from amounts reported in prior years are primarily adjustments to conform to the tax returns as filed. The Company had income taxes payable of $196,910 at December 31, 2009 and income taxes receivable of $115,000 at December 31, 2008.

The Company and its subsidiary file an income tax return in the U.S. federal jurisdiction and a franchise tax return in the State of California jurisdiction. The Company is no longer subject to U.S. federal income tax examinations and State franchise tax examinations by taxing authorities for years prior to 2006 and 2005, respectively.

FASB ASC 740-10 clarifies the accounting for income taxes, by prescribing a minimum recognition threshold a tax position taken or expected to be taken in a tax return is required to meet before being recognized in the financial statements. The Company adopted provisions of FASB ASC 740-10, on January 1, 2007. There have been no adjustments identified for unrecognized tax benefits requiring an adjustment to the income statement since this pronouncement was implemented. The Company recognizes interest accrued and penalties related to unrecognized tax benefits in tax expense. The Company has recognized no interest or penalties since this pronouncement was implemented.

The Company recognizes interest accrued and penalties related to unrecognized tax benefits in tax expense. During the years ended December 31, 2009 and 2008, the Company recognized no interest and penalties.

As of December 31, 2009, the Company had federal and state net operating loss carryforwards available to reduce future taxable income as follows:

	Net Operating Loss Carryforward	Expiration Date
State	$ 1,716,804	2014
	520,003	2015
	120,860	2016
	$ 2,357,667	

As of December 31, 2009 and 2008, the Company also had state contribution carryforwards of $21,238 and $82,255, respectively, which expire in 2011 through 2012.

NOTE K – EARNINGS PER SHARE

The following is a computation of basic and diluted earnings per share for the years ended December 31, 2009 and 2008.

	2009	2008
Basic:		
Net income	$ 425,676	$ 193,357
Weighted-average common shares outstanding	1,732,399	1,694,952
Earnings per share	$ 0.25	$ 0.11

NOTE K – EARNINGS PER SHARE (Continued)

	2009	2008
Diluted:		
Net income	$ 425,676	$ 193,357
Weighted-average common shares outstanding	1,732,399	1,694,952
Net effect of dilutive stock options - based on the Treasury stock method using average market price	27,602	101,159
Weighted-average common shares outstanding and common stock equivalents	1,760,001	1,796,111
Earnings per share - assuming dilution	$ 0.24	$ 0.11

Options to purchase 24,000 shares of common stock at $13.33 to $14.67 per share and 95,230 shares of restricted stock were outstanding during 2009 but were not included in the computation of diluted earnings per share because the options' exercise price and stock issuance price was greater than the average market price of the common shares. Options to purchase 24,000 shares of common stock and 16,850 shares of restricted stock were outstanding during 2008, but were not included in the computation of diluted earnings per share.

NOTE L – STOCK OPTION PLAN

The Company has a stock option plan established in 2004 under which incentive and nonstatutory stock options and restricted stock may be granted. The Company's Stock Option Plan provides for the granting of a maximum of 495,000 shares of the Company's common stock to directors, key employees and consultants at an exercise price not less than the fair market value of the shares on the date of grant and for a term of no more than 10 years. Options granted vest at a rate of 20% per year over five years from the date the option is granted. Generally, if an optionee's continuous status as a director, employee or consultant is terminated for various reasons, the nonvested options expire.

A summary of stock option activity follows for years ended December 31:

	Stock Options			
	2009		2008	
	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price	Shares
Shares under option at beginning of year	$ 7.37	249,920	$ 7.39	302,983
Options exercised	6.67	(840)	6.67	(46,358)
Options forfeited			13.22	(6,705)
Shares under option at end of year	7.37	249,080	7.39	249,920
Options exercisable at end of year		244,719		232,248

NOTE L – STOCK OPTION PLAN (Continued)

Following is the intrinsic value and weighted-average contractual term of stock options outstanding for the years ended December 31:

	Stock Options	
	2009	2008
Intrinsic value:		
Outstanding shares	$ 70,518	$ 753,059
Exercisable shares	70,518	724,721
Weighted-average remaining contractual term:		
Outstanding shares	4.29 years	5.29 years
Exercisable shares	4.26 years	5.23 years

Upon the exercise of stock options, new shares are issued. The total amount of cash received from the exercise of stock options during 2009 and 2008 was $5,603 and $309,207, respectively. There were no tax benefits realized from stock options exercised during 2009 and 2008.

A summary of the status of the Company's nonvested shares as of December 31, and changes during the years ended December 31, is presented below:

	2009		2008	
Nonvested Shares	Weighted-Average Grant Date Fair Value	Shares	Weighted-Average Grant Date Fair Value	Shares
Nonvested at beginning of year	$ 2.78	17,672	$ 2.01	87,434
Vested	2.33	(13,311)	1.64	(63,052)
Forfeited			3.54	(6,710)
Nonvested at end of year	4.07	4,361	2.78	17,672

As of December 31, 2009 and 2008, there was $23,381 and $58,228 of total unrecognized compensation cost related to nonvested stock options granted under the Plan. That cost is expected to be recognized over a weighted-average period of 1.05 years and 2 years, respectively. The total fair value of shares vested during the years ended December 31, 2009 and 2008, was $31,081 and $103,504, respectively.

NOTE L – STOCK OPTION PLAN (Continued)

A summary of restricted stock activity follows for the years ended December 31:

	Restricted Stock					
	2009			2008		
	Shares	Weighted-Average Grant Date Fair Value	Aggregate Intrinsic Value	Shares	Weighted-Average Grant Date Fair Value	Aggregate Intrinsic Value
Nonvested at beginning of year	16,850	$ 12.20		8,250	$ 12.50	
Granted	82,080	8.00		11,250	12.00	
Shares vested and issued	(3,700)	12.22		(1,650)	12.50	
Forfeited				(1,000)	12.50	
Nonvested at end of year	95,230	8.58	$ 664,705	16,850	12.20	$ 168,500

As of December 31, 2009 and 2008, there was $700,273 and $172,128 of total unrecognized compensation cost related to nonvested restricted stock. That cost is expected to be recognized over a weighted-average period of 5.94 and 6 years, respectively.

Total compensation cost for all share-based payments recognized in net income for 2009 and 2008 totaled $152,797 and $152,958, respectively. No tax benefit was recognized related to this compensation cost.

NOTE M – RELATED PARTY TRANSACTIONS

During the normal course of business, the Company has entered into transactions with its directors, executive officers, significant shareholders and their affiliates (related parties). The aggregate amount of loans to such related parties totaled $4,018,205 and $2,950,094 at December 31, 2009 and 2008, respectively. At December 31, 2009 and 2008, commitments to related parties of $2,397,910 and $398,416, respectively, were undisbursed. The Company has received deposits from directors and officers and their related interests totaling $3,654,961 and $4,230,850 at December 31, 2009 and 2008, respectively.

In addition, during 2009, the Company contracted with one of its directors to remodel the basement of their building. The total cost of this remodel was $79,622. The Company also entered into a lease agreement with another director's business late in 2009 as the landlord for two office spaces. The total rent received for 2009 was $3,802.

NOTE N – CONTINGENT LIABILITIES AND COMMITMENTS

Financial Instruments with Off-Balance-Sheet Risk: The Company's financial statements do not reflect various commitments and contingent liabilities which arise in the normal course of business and which involve elements of credit risk, interest rate risk and liquidity risk. These commitments and contingent liabilities are commitments to extend credit and standby letters of credit. A summary of the Company's commitments and contingent liabilities at December 31, 2009 and 2008 are as follows:

NOTE N – CONTINGENT LIABILITIES AND COMMITMENTS (Continued)

	Contractual Amounts	
	2009	2008
Commitments to extend credit	$ 38,381,030	$ 38,141,119
Standby letters of credit	210,385	777,807

Commitments to extend credit and standby letters of credit include exposure to some credit loss in the event of nonperformance of the customer. The Company's credit policies and procedures for credit commitments and financial guarantees are the same as those for extension of credit that are recorded on the balance sheet. Because most of these instruments have fixed maturity dates, and because many of them expire without being drawn upon, they do not generally present any significant liquidity risk to the Company.

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. The Company evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the customer. Collateral held varies but may include accounts receivable, inventory, deeds of trust on residential real estate and income-producing commercial properties.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending facilities to customers.

The Company did not incur any losses on its commitments in 2009 and 2008.

NOTE O – CONCENTRATIONS OF CREDIT RISK

Most of the Company's business activity is with customers located within the State of California, primarily in and around the City of Eureka. Most of the Company's loans have been granted to customers in the Company's market area. General economic conditions or natural disasters affecting the primary market area could affect the ability of customers to repay loans and the value of real property used as collateral. The loans are expected to be repaid from cash flow or proceeds from the sale of selected assets of the borrowers. The Company requires that all loans have adequate collateral to secure the loan or that the borrower has evidence of sufficient cash flows to repay loans when the loans are made. All collateral must have an appraisal, if applicable, and collateral is generally secured by liens. The Company's access to this collateral is through judicial procedures.

The concentrations of credit by type of loan are set forth in Note D. Approximately 78% of the Company's loans are collateralized by real estate in the Company's service area. The National Banking Laws, Title 12 of the United States Code, generally restricts loans to a single borrower or group of related borrowers and investments by the Company to 15% of the sum of the Company's equity capital plus the allowance for loan losses, subject to certain adjustments. The Company evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company, upon extension of credit, is based on management's credit evaluation of the customer. Collateral held varies but may include residential and commercial real property, marketable securities, accounts receivable, inventory, equipment and savings accounts.

The concentrations by type of investment security are set forth in Note C. The Company places its investments primarily in financial instruments backed by the U.S. Government and its agencies. At December 31, 2009, the Bank has $22,450,000 in federal funds sold to one correspondent banks, which represents 151% of the Bank's net worth.

NOTE P – REGULATORY MATTERS

The Bank is subject to the dividend restrictions set forth by the FDIC. Under such restrictions, the Bank may not, without the prior approval of the FDIC, declare dividends in excess of the sum of the current year's net income plus the retained earnings from the prior two years. As of December 31, 2009, $2,282,355 was available for cash dividend distribution without prior approval.

The Company is subject to various regulatory capital requirements administered by its primary federal regulator, the FDIC. Failure to meet minimum capital requirements can initiate certain mandatory – and possibly additional discretionary – actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company must meet specific capital guidelines that involve quantitative measures of the Company's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Company's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital (as defined) to average assets (as defined). Management believes, as of December 31, 2009, that the Company meets all capital adequacy requirements to which it is subject.

As of December 31, 2009, the most recent notification from the FDIC categorized the Company as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized the Company must maintain minimum total risk-based, Tier I risk-based and Tier I leverage ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed the Company's category. The Company's actual capital amounts and ratios are also presented in the table.

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
			(in thousands)			
As of December 31, 2009						
Total Capital						
(to Risk Weighted Assets)	$ 16,342	11.76%	≥ $ 11,114	≥ 8.00%	≥ $ 13,893	≥ 10.00%
Tier I Capital						
(to Risk Weighted Assets)	$ 14,598	10.51%	≥ $ 5,557	≥ 4.00%	≥ $ 8,336	≥ 6.00%
Tier I Capital						
(to Average Assets)	$ 14,598	7.69%	≥ $ 7,592	≥ 4.00%	≥ $ 9,489	≥ 5.00%
As of December 31, 2008						
Total Capital						
(to Risk Weighted Assets)	$ 14,635	10.90%	≥ $ 10,743	≥ 8.00%	≥ $ 13,429	≥ 10.00%
Tier I Capital						
(to Risk Weighted Assets)	$ 13,043	9.71%	≥ $ 5,371	≥ 4.00%	≥ $ 8,057	≥ 6.00%
Tier I Capital						
(to Average Assets)	$ 13,043	8.61%	≥ $ 6,061	≥ 4.00%	≥ $ 7,577	≥ 5.00%

NOTE Q – FAIR VALUES OF FINANCIAL INSTRUMENTS

FASB ASC 825 requires disclosure of fair value information about financial instruments, whether or not recognized in the balance sheet. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used,

NOTE Q – FAIR VALUES OF FINANCIAL INSTRUMENTS (Continued)

including the discount rate and estimates of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in immediate settlement of the instruments. FASB ASC 825 excludes certain financial instruments and all nonfinancial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company as a whole. The estimated fair values of the Company's financial instruments are as follows at December 31:

	2009		2008	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:				
Cash and due from banks	$ 3,472,096	$ 3,472,096	$ 5,582,425	$ 5,582,425
Federal funds sold	22,450,000	22,450,000	9,615,000	4,615,000
Investment securities available-for-sale	15,951,348	15,951,348	10,253,071	10,253,071
Loans, net	134,209,255	134,179,037	127,841,123	130,360,832
Cash surrender value of life insurance	2,398,504	2,398,504	2,298,540	2,298,540
Accrued interest receivable	667,778	667,778	607,919	607,919
Financial liabilities:				
Deposits	169,126,153	169,119,096	147,436,018	116,834,391
Borrowings	1,500,250	1,500,256	3,000,000	3,000,000
Accrued interest payable	84,804	84,804	115,405	201,455

The carrying amounts in the preceding table are included in the balance sheet under the applicable captions. The following methods and assumptions were used by the Company in estimating its fair value disclosures for financial instruments:

Cash and due from banks, federal funds sold and interest-bearing deposits in other banks: The carrying amount is a reasonable estimate of fair value.

Investment securities: Fair values for investment securities are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments. The carrying amount of accrued interest receivable approximates its fair value.

Loans, net: For variable-rate loans that reprice frequently and fixed rate loans that mature in the near future, with no significant change in credit risk, fair values are based on carrying amounts. The fair values for other fixed rate loans are estimated using discounted cash flow analysis, based on interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Loan fair value estimates include judgments regarding future expected loss experience and risk characteristics and are adjusted for the allowance for loan losses. The carrying amount of accrued interest receivable approximates its fair value.

Cash surrender value of life insurance: The carrying amount approximates fair value.

Deposits: The fair values disclosed for demand deposits (for example, interest-bearing checking, money market and savings accounts) are, by definition, equal to the amount payable on demand at the reporting date (that is, their carrying amounts). The fair values for certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on the certificates to a schedule of aggregated contractual maturities on such time deposits. The carrying amount of accrued interest payable approximates fair value.

NOTE Q – FAIR VALUES OF FINANCIAL INSTRUMENTS (Continued)

Borrowings: The carrying amount approximates fair value.

Fair value is a market-based measure considered from the perspective of a market participant who holds the asset or owes the liability rather than an entity-specific measure. Therefore, even when market assumptions are not readily available, the Company's own assumptions are set to reflect those that market participants would use in pricing the asset or liability at the measurement date. The Company uses prices and inputs that are current as of the measurement date, including during periods of market dislocation, the observability of prices and inputs may be reduced for many instruments. This condition could cause an instrument to be reclassified from Level 1 to Level 2 or Level 2 to Level 3.

In general, fair values are determined by:

Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access.

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. 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 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.

<u>Securities Available-for-Sale</u>: Assets measured at fair value on a recurring basis consist of securities available-for-sale with a fair value of $15,951,348 and $10,253,071 at December 31, 2009 and 2008, respectively, all of which are valued using Level 2 inputs. To value securities available-for-sale, the Company obtains fair value measurements from an independent pricing service. The fair value measurement considers observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions among other things.

<u>Impaired Loans</u>: The Company may be required, from time to time, to measure certain assets at fair value on a nonrecurring basis in accordance with U.S. generally accepted accounting principles. These include assets that are measured at the lower of cost or market that were recognized at fair value below cost at the end of the period. Assets measured at fair value on a nonrecurring basis include impaired loans with a fair value of $1,151,987 at December 31, 2009 and $2,465,120 at December 31, 2008, all of which utilized Level 2 inputs. The fair value of impaired loans is estimated using one of several methods, including collateral value, market value of similar debt, enterprise value, liquidation value and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. At December 31, 2009 and 2008, all of the impaired loans were evaluated based on the fair value of the collateral. Impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraisal value, the Company records the impaired loan as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the impaired loan as nonrecurring level 3.

NOTE R – CONDENSED FINANCIAL INFORMATION OF THE PARENT COMPANY

Condensed balance sheets as of December 31, 2009 and 2008 and the related condensed statement of operations and cash flows for the years then ended for Redwood Capital Bancorp (parent company only) are presented as follows:

Condensed Balance Sheets
December 31, 2009 and 2008

	2009	2008
Assets		
Cash	$ 1,764,941	$ 453,685
Other assets	8,350	
Intercompany receivable	1,600	800
Investment in subsidiary	14,856,973	13,471,576
	$ 16,631,864	$ 13,926,061
Liabilities and shareholders' equity		
Accrued interest payable and other liabilities	$ 86,798	$ 93,938
Other borrowings	1,500,250	3,000,000
Preferred stock	3,824,214	
Common stock	11,699,908	11,611,403
Additional paid-in capital	562,054	455,759
Retained earnings (deficit)	(1,041,360)	(1,235,039)
	$ 16,631,864	$ 13,926,061

Condensed Statements of Operations
For the years ended December 31, 2009 and 2008

	2009	2008
Interest expense	$ (24,697)	$ (115,313)
Other expenses	(342,128)	(330,987)
Loss before equity in undistributed income of subsidiary and income taxes	(366,825)	(446,300)
Equity in undistributed net income of subsidiary	793,301	640,457
Income tax expense	(800)	(800)
	$ 425,676	$ 193,357

NOTE R – CONDENSED FINANCIAL INFORMATION OF THE PARENT COMPANY (Continued)

Condensed Statements of Cash Flows
For the years ended December 31, 2009 and 2008

	2009	2008
Cash flows from operating activities:		
Net income	$ 425,676	$ 193,357
Adjustments to reconcile net income to net cash used by operating activities:		
Equity in undistributed income of subsidiary	(793,301)	(640,457)
Stock-based compensation expense	152,797	152,958
Restricted stock awarded	36,400	
Change in other assets	(8,350)	10,625
Change in intercompany receivable	(800)	(800)
Change in interest payable and other liabilities	(24,298)	26,556
Net cash used by operating activities	(211,876)	(257,761)
Cash flows from investing activities:		
Capital infusion	(600,000)	(1,685,000)
Net cash used by investing activities	(600,000)	(1,685,000)
Cash flows from financing activities:		
Repayments of borrowings	(3,000,000)	
Proceeds from other borrowings	1,500,250	1,685,000
Proceeds from issuance of preferred stock	3,789,388	
Proceeds from exercise of stock options	5,603	309,207
Dividends paid on preferred stock	(172,109)	
Net cash provided by financing activities	2,123,132	1,994,207
Net increase in cash	1,311,256	51,446
Cash at beginning of year	453,685	402,239
CASH AT END OF YEAR	$ 1,764,941	$ 453,685