PENINSULA BANK HOLDING CO. AND SUBSIDIARY

CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2008 AND 2007

AND FOR THE YEARS ENDED

DECEMBER 31, 2008, 2007 AND 2006

AND

INDEPENDENT AUDITOR'S REPORT

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INDEPENDENT AUDITOR'S REPORT

The Shareholders and
Board of Directors
Peninsula Bank Holding Co. and Subsidiary

We have audited the accompanying consolidated balance sheet of Peninsula Bank Holding Co. and subsidiary as of December 31, 2008 and 2007 and the related consolidated statements of operations, changes in shareholders' equity and cash flows for each of the years in the three-year period ended December 31, 2008. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Peninsula Bank Holding Co. and subsidiary as of December 31, 2008 and 2007 and the consolidated results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2008, in conformity with accounting principles generally accepted in the United States of America.

Perry-Smith LLP

February 17, 2009

PENINSULA BANK HOLDING CO. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEET
December 31, 2008 and 2007

	2008	2007
ASSETS		
Cash and cash equivalents	$ 38,386,330	$ 7,631,417
Federal funds sold	4,945,000	16,890,000
Total cash and cash equivalents	43,331,330	24,521,417
Interest bearing deposits in other banks	15,764,700	4,845,000
Available-for-sale investment securities (Note 2)	8,138,000	22,066,000
Loans, less allowance for loan losses of $3,748,541 in 2008 and $1,536,534 in 2007 (Notes 3 and 9)	198,137,324	144,254,463
Federal Home Loan Bank Stock	730,200	-
Property and equipment, net (Note 4)	864,035	651,828
Cash surrender value of life insurance policies (Note 5)	2,991,219	2,880,575
Accrued interest receivable and other assets	1,550,601	1,231,555
Total assets	$ 271,507,409	$ 200,450,838
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Non-interest bearing	$ 56,205,304	$ 29,495,022
Interest bearing (Note 6)	191,793,146	154,722,017
Total deposits	247,998,450	184,217,039
Accrued interest payable and other liabilities	875,429	653,055
Total liabilities	248,873,879	184,870,094
Commitments (Note 9)		
Shareholders' equity (Note 10 and 11):		
Preferred stock - no par value; 5,000,000 shares authorized, no shares issued or outstanding	-	-
Common stock - no par value; 5,000,000 shares authorized; 2,602,276 and 1,889,375 shares issued and outstanding in 2008 and 2007, respectively	27,428,052	18,857,568
Additional paid-in capital	817,904	548,677
Accumulated deficit	(5,694,990)	(3,892,894)
Accumulated other comprehensive income, net of taxes (Note 2)	82,564	67,393
Total shareholders' equity	22,633,530	15,580,744
Total liabilities and shareholders' equity	$ 271,507,409	$ 200,450,838

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

PENINSULA BANK HOLDING CO. AND SUBSIDIARY
CONSOLIDATED STATEMENT OF OPERATIONS
For the Years Ended December 31, 2008, 2007 and 2006

	2008	2007	2006
Interest income:			
Interest and fees on loans	$ 11,647,890	$ 9,164,338	$ 5,327,949
Interest on Federal funds sold	656,655	1,353,294	553,753
Interest on investment securities	507,710	535,586	629,333
Total interest income	12,812,255	11,053,218	6,511,035
Interest expense:			
Interest on deposits (Note 6)	4,686,883	4,745,586	2,114,630
Net interest income	8,125,372	6,307,632	4,396,405
Provision for loan losses (Note 3)	3,212,425	549,524	456,774
Net interest income after provision for loan losses	4,912,947	5,758,108	3,939,631
Non-interest income:			
Service charges, fees and other income	133,920	107,681	24,766
Appreciation in cash surrender value of insurance contracts (Note 5)	110,644	107,004	98,135
Total non-interest income	244,564	214,685	122,901
Non-interest expenses:			
Salaries and employee benefits (Note 12)	3,877,278	3,036,416	2,326,792
Occupancy and equipment (Notes 4 and 9)	1,416,750	873,625	657,008
Other (Notes 4 and 14)	1,560,579	1,224,067	1,305,840
Total other expenses	6,854,607	5,134,108	4,289,640
(Loss) income before provision for income taxes	(1,697,096)	838,685	(227,108)
Provision for income taxes (Note 7)	105,000	-	-
Net (loss) income	$ (1,802,096)	$ 838,685	$ (227,108)
Basic (loss) income per share (Note 10)	$ (0.81)	$ 0.45	$ (0.12)
Diluted (loss) income per share (Note 10)	$ (0.81)	$ 0.43	$ (0.12)

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

PENINSULA BANK HOLDING CO. AND SUBSIDIARY
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
For the Years Ended December 31, 2008, 2007 and 2006

	Common Stock				Accumulated Other Comprehensive Income (Loss),	Total	Total
	Shares	Amount	Additional Paid-in Capital	Accumulated Deficit	Net of Tax	Shareholders' Equity	Comprehensive Income(Loss)
Balance, January 1, 2006	1,852,625	$18,514,275	$ 206,732	$ (4,504,471)	$ (139,249)	$ 14,077,287	
Comprehensive loss:							
Net loss				(227,108)		(227,108)	$ (227,108)
Other comprehensive income:							
Net change in unrealized losses on available-for-sale investment securities					101,058	101,058	101,058
Total comprehensive loss							$ (126,050)
Stock options exercised	11,500	66,250				66,250	
Stock based compensation (Notes 1 and 11)			113,669			113,669	
Balance, December 31, 2006	1,864,125	18,580,525	320,401	(4,731,579)	(38,191)	14,131,156	
Comprehensive income:							
Net income				838,685		838,685	$ 838,685
Other comprehensive income:							
Net change in unrealized losses on available-for-sale investment securities					105,584	105,584	105,584
Total comprehensive income							$ 944,269
Stock options exercised	25,250	277,043				277,043	
Stock based compensation (Notes 1 and 11)			228,276			228,276	
Balance, December 31, 2007	1,889,375	18,857,568	548,677	(3,892,894)	67,393	15,580,744	
Comprehensive loss:							
Net loss				(1,802,096)		(1,802,096)	$ (1,802,096)
Other comprehensive income, net of taxes:							
Net change in unrealized gain on available-for-sale investment securities					15,171	15,171	15,171
Total comprehensive loss							$ (1,786,925)
Proceeds from stock offering	690,501	8,346,484				8,346,484	
Stock options exercised	22,400	224,000				224,000	
Stock based compensation (Notes 1 and 11)			269,227			269,227	
Balance, December 31, 2008	2,602,276	$27,428,052	$ 817,904	$ (5,694,990)	$ 82,564	$ 22,633,530	

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

PENINSULA BANK HOLDING CO. AND SUBSIDIARY
CONSOLIDATED STATEMENT OF CASH FLOWS
For the Years Ended December 31, 2008, 2007 and 2006

	2008	2007	2006
Cash flows from operating activities:			
Net (loss) income	$ (1,802,096)	$ 838,685	$ (227,108)
Adjustments to reconcile net (loss) income to net cash provided by operating activities:			
(Gain) Loss on disposal of equipment	(6,305)	6,187	7,327
Provision for loan losses	3,212,425	549,524	456,774
Depreciation, amortization and accretion	299,541	205,452	284,639
Increase (decrease) in deferred loan fees and origination costs, net	327,054	18,992	(54,220)
Net increase in cash value of life insurance policies	(110,644)	(107,004)	(98,135)
Stock option compensation expense	269,227	228,276	113,669
Increase in accrued interest receivable and other assets	(374,089)	(418,555)	(170,741)
Increase in accrued interest payable and other liabilities	222,374	204,468	256,389
Net cash provided by operating activities	2,037,487	1,526,025	568,594
Cash flows used in investing activities:			
Purchase of available-for-sale investment securities	(5,000,000)	(21,993,541)	(3,000,000)
Proceeds from sales or calls of available-for-sale investment securities	4,000,000	3,000,000	-
Proceeds from maturities of available-for-sale investment securities	15,000,000	5,550,000	10,950,000
Net (increase) decrease in interest bearing deposits in other banks	(10,919,700)	(2,245,000)	1,500,000
Purchase of Federal Home Loan Bank Stock	(730,200)		
Net increase in loans	(57,422,341)	(53,552,138)	(41,782,504)
Purchase of premises and equipment	(534,528)	(258,612)	(222,336)
Proceeds from sale of equipment	27,300		
Net cash used in investing activities	(55,579,469)	(69,499,291)	(32,554,840)
Cash flows from financing activities:			
Net increase in demand, interest bearing and savings deposits	70,985,027	63,017,065	13,411,834
Net (decrease) increase in time deposits	(7,203,616)	13,307,707	26,993,585
Net proceeds from stock offering	8,346,484	-	-
Proceeds from exercise of stock options	224,000	277,044	66,250
Net cash provided by financing activities	72,351,895	76,601,816	40,471,669
Increase in cash and cash equivalents	18,809,913	8,628,550	8,485,423
Cash and cash equivalents at beginning of period	24,521,417	15,892,867	7,407,444
Cash and cash equivalents at end of year	$ 43,331,330	$ 24,521,417	$ 15,892,867
Supplemental disclosure of cash flow information:			
Cash paid during the year for:			
Interest expense	$ 4,877,336	$ 4,635,791	$ 2,006,597
Income taxes	$ 45,100	$ -	$ -
Non-cash investing activities:			
Net change in unrealized gain on available-for-sale investment securities	$ 15,171	$ 105,584	$ 101,058

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General

Peninsula Bank Holding Co. (the "Company") was incorporated on December 17, 2007 and subsequently obtained approval from the Board of Governors of the Federal Reserve System to operate as a bank holding company. On April 2, 2008, The Private Bank of the Peninsula (the "Bank") consummated a merger with the Company that was effected through the exchange of one share of the Company's stock for each share of the Bank's stock. The reorganization represented an exchange of shares between entities under common control, and, as a result, assets and liabilities of the Bank were recognized at their carrying amounts in the accounts of the Company. Subsequent to the reorganization, the Bank continued its operations as previously conducted, but as a wholly-owned subsidiary of the Company.

The Bank, a California state-chartered institution, opened for business on October 1, 2003, and provides financial products and services to customers who are predominately small and middle-market businesses, professionals and individuals residing in San Mateo and Santa Clara Counties.

The Bank is participating in the FDIC's Transaction Account Guarantee Program. Under this program, through December 31, 2009, all noninterest-bearing transaction accounts are fully guaranteed by the FDIC for the entire amount in the account and the Bank is assessed an annual fee of 10 basis points for all deposit amounts exceeding the existing deposit insurance limit of $250,000. Coverage under the Transaction Account Guarantee Program is in addition to and separate from the coverage available under the FDIC's general deposit insurance rules.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and the accounts of its wholly-owned subsidiary, the Bank. All significant intercompany balances and transactions have been eliminated.

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

Reclassifications

Certain items have been reclassified in prior year balances to achieve consistency with the 2008 presentation.

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 the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Cash and Cash Equivalents

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Investment Securities

Investment securities are classified into the following categories:

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

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

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

Gains and losses on the sale of 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. In addition, unrealized losses that are other than temporary are recognized in earnings for all investments.

Investment securities are evaluated for impairment on at least a quarterly basis and more frequently when economic or market conditions warrant such an evaluation to determine whether a decline in their value is other than temporary. Management utilizes criteria such as the magnitude and duration of the decline and the intent and ability of the Bank to retain its investment in the issues for a period of time sufficient to allow for an anticipated recovery in fair value, in addition to the reasons underlying the decline, to determine whether the loss in value is other than temporary. The term "other than temporary" is not intended to indicate that the decline is permanent, but indicates that the prospects for a near-term recovery of value are not necessarily favorable, or that there is a lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. Once a decline in value is determined to be other than temporary, the value of the security is reduced and a corresponding charge to earnings is recognized.

Investment in Federal Home Loan Bank Stock

As a member of the Federal Home Loan Bank System, the Bank is required to maintain an investment in the capital stock of the Federal Home Loan Bank (FHLB). The investment is carried at cost. At December 31, 2008, FHLB stock totaled $730,200.

Loans

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Loans (continued)

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

An impaired loan is measured based on the lesser of the present value of expected future cash flows discounted at the loan's effective rate, the loan's observable market price or the fair value of collateral if the loan is collateral dependent. A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due (including both principal and interest) in accordance with the contractual terms of the loan agreement.

Allowance for Loan Losses

The allowance for loan losses is maintained to provide for losses related to impaired loans and other losses that can be expected to occur in the normal course of business. The determination of the allowance is based on estimates made by management, to include consideration of the character of the loan portfolio, specifically identified problem loans, potential losses inherent in the portfolio taken as a whole and economic conditions in the Company's service area.

Loans determined to be impaired or classified are individually evaluated by management for specific risk of loss. In addition, reserve factors are assigned to currently performing loans based on management's assessment of the following for each identified loan type: (1) inherent credit risk and (2) historical losses. Management also computes specific and expected loss reserves for loan commitments. These estimates are particularly susceptible to changes in the economic environment and market conditions.

The Company's Loan Committee and Board review the adequacy of the allowance for loan losses at least quarterly, to include consideration of the relative risks in the portfolio and current economic conditions. The allowance is adjusted based on that review if, in the judgment of the Loan Committee, management and Board, changes are warranted.

The allowance is established through a provision for loan losses which is charged to expense. Additions to the allowance are expected to maintain the adequacy of the total allowance after credit losses and loan growth. The allowance for loan losses at December 31, 2008 and 2007 reflects management's estimate of possible losses in the portfolio.

Reserve for Undisbursed Loan Commitments

The Company maintains a separate reserve for losses related to undisbursed loan commitments. Management estimates the amount of probable losses by applying the loss factors used in the allowance for loan loss methodology to an estimate of the expected usage and applies the factor to the unused portion of undisbursed lines of credit. This reserve totaled $221,261 and $203,172 at December 31, 2008 and 2007, respectively, and is included in accrued interest payable and other liabilities on the balance sheet.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Property and Equipment

Property and equipment are carried at cost. Depreciation is determined using the straight line method over the estimated useful lives of the related assets. The useful lives of furniture, fixtures and equipment are estimated to be five to ten years. Leasehold improvements are amortized over the life of the asset or the term of the related lease, whichever is shorter. When assets are sold or otherwise disposed of, the cost and related accumulated depreciation or amortization are removed from the accounts, and any resulting gain or loss is recognized in income for the period. The cost of maintenance and repairs is charged to expense as incurred.

Rental Income

The Company subleases space to tenants in vacated former loan production, branch and administrative offices. Rental income is recorded when earned as a component of "Occupancy and Equipment" expense. All leases are operating leases, as disclosed in Note 9, and do not contain up front considerations.

Income Taxes

Deferred tax assets and liabilities are recognized for the tax consequences of temporary differences between reported amounts of assets and liabilities and their tax bases. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment. A valuation allowance is recognized if, based on the weight of available evidence, management believes it is more likely than not that some portion or all of the deferred tax asset will not be realized.

On January 1, 2007 the Company adopted Financial Accounting Standards Board (FASB) Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes. FIN 48 prescribes a recognition threshold and measurement standard for the financial statement recognition and measurement of an income tax position taken or expected to be taken in a tax return. In addition, FIN 48 provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

The provisions of FIN 48 have been applied to all tax positions of the Company, and previously the Bank, as of January 1, 2007. Only tax positions that met the more-likely-than-not recognition threshold on January 1, 2007 were recognized or continue to be recognized upon adoption. The Bank previously recognized income tax positions based on management's estimate of whether it was reasonably possible that a liability has been incurred for unrecognized income tax benefits by applying FASB Statement No. 5, *Accounting for Contingencies*.

Stock-Based Compensation

Effective January 1, 2006, the Bank adopted the disclosure requirements of the Statement of Financial Accounting Standards No. 123(R), *Share-Based Payment* (SFAS 123(R)). Prior to January 1, 2006, the Bank accounted for these plans under the recognition and measurement principles of SFAS 123 *Accounting for Stock-Based* Compensation, which requires the Bank to record compensation cost for all share-based payments based on the estimated grant date fair values of the options.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Stock-Based Compensation (continued)

Coincidental with the acquisition of the Bank by the Company, outstanding options under The Private Bank of the Peninsula 2003 Stock Option Plan were assumed by the Company's 2008 Stock Option Plan. There were 310,399 options granted in 2008 and 188,500 granted in 2007.

SFAS 123(R) requires the cash flows resulting from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) to be classified as a cash flow from financing in the statement of cash flows. There were no excess tax benefits for the years ended December 31, 2008 and 2007.

The Company bases the fair value of the options previously granted on the date of grant using a Black-Scholes option pricing model that uses assumptions based on expected option life, the level of estimated forfeitures, expected stock volatility and the risk-free interest rate. Stock volatility is based on the historical volatility of the Company's stock. The risk-free rate is based on the U.S. Treasury yield curve and the expected term of the options. The "simplified" method described in SEC Staff Accounting Bulletin No. 107 was used to determine the expected term of the Company's options in 2008 and 2007.

The fair value of each option is estimated on the date of grant using the following assumptions:

	2008	2007	2006
Dividend yield	0.00%	0.00%	0.00%
Expected volatility	25.24%	20.73%	13.29%
Risk-free interest rate	2.62%	4.64%	4.65%
Expected option life	2.9 years	4 years	4 years

Earnings (Loss) Per Share

Basic earnings (loss) per share (EPS), which excludes dilution, is computed by dividing income (loss) by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock, such as stock options, result in the issuance of common stock which shares in the earnings of the Company. The treasury stock method is applied to determine the dilutive effect of stock options in computing diluted EPS. However, diluted EPS is not presented when a net loss occurs because the conversion of potential common stock is antidilutive.

Comprehensive Income (Loss)

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Impact of New Financial Accounting Standards - Issued and Effective

Fair Value Measurements

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements, which defines and establishes a framework for measuring fair value used in FASB pronouncements that require or permit fair value measurement. This statement expands disclosures using fair value to measure assets and liabilities in interim and annual periods subsequent to the period of initial recognition. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those years. Management adopted this statement on January 1, 2008. The impact of adoption was not material to the Company's financial condition or results of operations. See Note 16. – Fair Value of Financial Assets.

The Fair Value Option for Financial Assets and Financial Liabilities

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities ("SFAS No. 159"), including an amendment of FASB Statement No. 115. SFAS No.159 permits fair value accounting to be irrevocably elected for certain financial assets and liabilities at the time of acquisition on an individual contract basis or at a remeasurement event date. Upon adoption of SFAS No. 159, fair value accounting may also be elected for existing financial assets and liabilities. For those instruments for which fair value accounting is elected, changes in fair value will be recognized in earnings, and fees and costs associated with origination or acquisition will be recognized as incurred rather than deferred. The Company adopted SFAS No. 159 on January 1, 2008, but did not elect the fair value option for any assets or liabilities for the year ended December 31, 2008.

In addition, in October 2008, the FASB issued FSP FAS 157-3, Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active . The FSP clarifies the application of FASB Statement No. 157, Fair Value Measurements, in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. The FSP is effective immediately, and includes prior period financial statements that have not yet been issued, and therefore the Company is subject to the provision of the FSP effective immediately. The impact of adoption was not material to the Company's financial condition or results of operations.

Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements

In September 2006, the Financial Accounting Standards Board ("FASB") ratified the Emerging Issues Task Force ("EITF") conclusion under EITF Issue No. 06-4," Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements" ("EITF 06-4"). EITF 06-4 requires that endorsement split-dollar life insurance arrangements which provide a postretirement benefit to an employee be recorded in accordance with FASB Statement No. 106, Employer's Accounting for Postretirement Benefits Other Than Pensions or APB Opinion No. 12, Omnibus Opinion—1967, based on the substance of the agreement with the employee.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Impact of New Financial Accounting Standards - Issued and Effective (continued)

Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements (continued)

Under the provisions of these Statements, if the employer has effectively agreed to maintain a life insurance policy during the employee's retirement, the cost of the insurance policy during postretirement periods should be accrued in accordance with either Statement 106 or Opinion 12. Similarly, if the employer has effectively agreed to provide the employee with a death benefit, the employer should accrue, over the service period, a liability for the actuarial present value of the future death benefit as of the employee's expected retirement date, in accordance with either Statement 106 or Opinion 12.

EITF 06-4 is effective for fiscal years beginning after December 15, 2007. The effects of adopting EITF 06-4 can be recorded either as (i) a change in accounting principle through a cumulative-effect adjustment to retained earnings or to other components of equity as of the beginning of the year of adoption, or (ii) a change in accounting principle through retrospective application to all prior periods. The Company adopted EITF 06-4 as of January 1, 2008, and the adoption of EITF 06-4 did not have a material impact on the Company's consolidated financial position, results of operations or cash flows.

Accounting Pronouncements Issued and Not Yet Effective

Business Combinations

In December 2007, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 141 (revised 2007), *Business Combinations* ("SFAS No. 141R"). SFAS No. 141(R), among other things, establishes principles and requirements for how the acquirer in a business combination (i) recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquired business, (ii) recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase, and (iii) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination.

The Company is required to adopt SFAS No. 141(R) for all business combinations for which the acquisition date is on or after January 1, 2009. Earlier adoption is prohibited. This standard will change the Company's accounting treatment for business combinations on a prospective basis.

Noncontrolling Interests in Consolidated Financial Statements

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160, Noncontrolling Interests in Consolidated Financial Statements, an Amendment of ARB No. 51 ("SFAS No. 160"). SFAS No. 160 establishes accounting and reporting standards for noncontrolling interests in a subsidiary and for the deconsolidation of a subsidiary. Minority interests will be recharacterized as noncontrolling interests and classified as a component of equity. It also establishes a single method of accounting for changes in a parent's ownership interest in a subsidiary and requires expanded disclosures. This statement is effective for fiscal years beginning on or after December 15, 2008, with early adoption prohibited. The Company does not expect the adoption of this Statement will have a material impact on the Company's consolidated financial position, results of operations or cash flows.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Accounting Pronouncements Issued and Not Yet Effective (continued)

Disclosures about Derivative Instruments and Hedging Activities

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities (SFAS No. 161). This statement requires enhanced disclosures to enable investors to better understand the effects of derivative instruments and hedging activities on an entity's financial position, financial performance, and cash flows, by requiring disclosure of the fair value of derivative instruments and their gains and losses in a tabular format. It also provides more information about an entity's liquidity by requiring disclosure of derivative features that are credit risk-related. It requires cross-referencing within footnotes to enable financial statement users to locate important information about derivative instruments. SFAS No. 161 is effective for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. Management does not expect the adoption of this Statement will have a material impact on the Company's consolidated financial position, results of operations or cash flows.

The Hierarchy of Generally Accepted Accounting Principles

In May 2008, the FASB issued SFAS No. 162, The Hierarchy of Generally Accepted Accounting Principles (SFAS No. 162). This standard identifies a consistent framework, or hierarchy, for selecting accounting principles to be used in preparing financial statements that are presented in conformity with U.S. generally accepted accounting principles for nongovernmental entities. It establishes that the GAAP hierarchy should be directed to entities because it is the entity (not the auditor) that is responsible for selecting accounting principles for financial statements that are presented in conformity with GAAP. Management does not believe that implementation of SFAS No. 162 will have any effect on the Company's consolidated financial position, results from operations or cash flows.

2. AVAILABLE-FOR-SALE INVESTMENT SECURITIES

The amortized cost and estimated fair value of available-for-sale investment securities at December 31, 2008 and 2007 consisted of the following:

	2008			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Sponsored Agencies	$ 8,000,394	$ 137,606	$ -	$ 8,138,000

	2007			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Treasuries	$ 14,997,906	$ 1,394	$ -	$ 14,999,300
U.S. Sponsored Agencies	7,000,701	65,999	-	7,066,700
Total debt securities	$ 21,998,607	$ 67,393	$ -	$ 22,066,000

Net unrealized gains on available-for-sale investment securities totaling $82,564 and $67,393 were recorded as other comprehensive income, net of taxes, within shareholders' equity at December 31, 2008 and 2007, respectively.

Proceeds from the sale or call of available-for-sale investment securities totaled $4,000,000 and $3,000,000 with no gains or losses for the years ended December 31, 2008 and 2007, respectively. There were no sales or calls of available-for-sale investment securities in the year ended December 31, 2006.

All investment securities held at December 31, 2008 have contractual maturities of one to five years. 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.

Investment securities with amortized costs totaling $4,500,298 and fair values of $4,579,337 were pledged to secure public deposits at December 31, 2008. Investment securities with amortized costs totaling $7,000,716 and fair values of $7,066,715 were pledged to secure public deposits at December 31, 2007.

3. LOANS

Outstanding loans are summarized below:

	December 31, 2008	December 31, 2007
Commercial	$ 31,092,770	$ 29,132,983
Construction	56,193,173	34,652,448
Real estate - residential	36,127,676	21,686,222
Real estate - commercial	66,866,603	54,432,288
Asset based lending	7,822,280	2,209,146
Other	4,041,543	3,609,026
Total outstanding loans	202,144,045	145,722,113
Deferred loan origination (fees) costs, net	(258,180)	68,884
Allowance for loan losses	(3,748,541)	(1,536,534)
Total loans net of reserve	$ 198,137,324	$ 144,254,463

Changes in the allowance for loan losses during the years ended December 31, 2008, 2007 and 2006 were as follows:

	2008	2007	2006
Balance, beginning of year	$ 1,536,534	$ 987,010	$ 530,236
Provision charged to operations	3,212,425	549,524	456,774
Losses charged to allowance	(1,001,633)	-	-
Recoveries	1,216	-	-
Balance, end of year	$ 3,748,541	$ 1,536,534	$ 987,010

3. LOANS (continued)

Nonaccrual loans totaled $4.26 million and $0 at December 31, 2008 and December 31, 2007, respectively. There were no accruing loans past due 90 days or more at December 31, 2008, 2007 or 2006.

At December 31, 2008 and December 31, 2007, the recorded investment in impaired loans was $4.26 million and $0, respectively. The Company had $865,000 of specific allowance for loan losses on impaired loans of $4.26 million at December 31, 2008. The average outstanding balance of impaired loans for the years ended December 31, 2008 and 2007 was $1.45 million and $0, respectively, on which $170,365 and $0 was recognized as interest income on a cash basis, for the years ended December 31, 2008 and 2007, respectively.

Salaries and employee benefits totaling $528,528, $439,541 and $351,965 have been deferred as loan origination costs for the years ended December 31, 2008, 2007 and 2006.

4. PROPERTY AND EQUIPMENT

Property and equipment consisted of the following:

	December 31, 2008	December 31, 2007
Furniture and equipment	$ 612,001	$ 536,124
Leasehold improvements	441,078	257,158
Computer equipment	682,598	471,476
Gross property and equipment	1,735,677	1,264,758
Less accumulated depreciation and amortization	871,642	612,930
Property and equipment, net	$ 864,035	$ 651,828

Depreciation included in occupancy and equipment expense totaled $301,237, $179,701 and $154,127 for the years ended December 31, 2008, 2007 and 2006.

5. CASH SURRENDER VALUE OF LIFE INSURANCE POLICIES

During 2004, the Bank purchased single-premium life insurance policies on the lives of two key executives. Income earned on these policies, net of expenses, totaled $110,644, $107,004 and $98,135 for the years ended December 31, 2008, 2007 and 2006, respectively.

6. INTEREST-BEARING DEPOSITS

Interest-bearing deposits consisted of the following:

	December 31, 2008	December 31, 2007
NOW accounts	$ 16,884,423	$ 18,218,380
Savings	1,460,455	367,639
Money market	122,519,392	78,003,506
Time, $100,000 or more	44,619,893	44,058,111
Other time	6,308,983	6,874,381
Brokered Deposits	-	7,200,000
Total interest-bearing deposits	$ 191,793,146	$ 154,722,017

Aggregate annual maturities of time deposits are as follows:

Year Ending December 31,	
2009	$ 50,176,513
2010	108,129
2011	192,996
2012	425,987
2013	25,251
Total time deposits	$ 50,928,876

Interest expense recognized on interest-bearing deposits for the years ended December 31, 2008, 2007 and 2006 consisted of the following:

	2008	2007	2006
NOW accounts	$ 128,191	$ 217,066	$ 80,104
Savings	19,438	4,889	822
Money market	2,400,281	2,031,533	692,992
Time, $100,000 or more	1,580,937	1,946,525	1,130,374
Other time	205,378	343,498	210,338
Brokered deposits and other interest	352,659	202,075	-
Total interest expense	$ 4,686,883	$ 4,745,586	$ 2,114,630

At December 31, 2008 and 2007, the Company had one deposit relationship that exceeded 5% of total deposits. The aggregate total of this deposit relationship was $31,556,621 and $17,345,935, at December 31, 2008 and 2007, respectively.

7. INCOME TAXES

The provision for income taxes for the years ended December 31, 2008, 2007 and 2006 consisted of the following:

2008	Federal	State	Total
Current	$ -	$ 105,000	$ 105,000
Deferred	(249,000)	(160,000)	(409,000)
Valuation allowance	249,000	160,000	409,000
Provision for income taxes	$ -	$ 105,000	$ 105,000

2007	Federal	State	Total
Current	$ -	$ -	$ -
Deferred	149,000	53,000	202,000
Valuation allowance	(149,000)	(53,000)	(202,000)
Provision for income taxes	$ -	$ -	$ -

2006	Federal	State	Total
Current	$ -	$ -	$ -
Deferred	(179,000)	(60,000)	(239,000)
Valuation allowance	179,000	60,000	239,000
Provision for income taxes	$ -	$ -	$ -

Deferred tax assets (liabilities) at December 31, 2008 and 2007 consisted of the following:

	2008	2007
Deferred tax assets:		
Net operating losses	$ 631,000	$ 1,424,000
Allowance for credit losses	1,705,000	712,000
Organization costs	-	60,000
Other	-	17,000
Share-base compensation	198,000	127,000
Contributions	26,000	-
Non-accrual interest	169,000	-
Deferred tax assets before valuation allowance	2,729,000	2,340,000
Valuation allowance	(2,064,000)	(1,683,000)
Total deferred tax assets	665,000	657,000

7. INCOME TAXES (Continued)

Deferred tax liabilities:		
Accrual to cash conversion	-	(287,000)
Loan origination costs	(208,000)	(191,000)
Unrealized gain on available for sale securities	(55,000)	(27,000)
Future liability of State deferred tax asset	(170,000)	(152,000)
Other	(232,000)	-
Total deferred tax liabilities	(665,000)	(657,000)
Net deferred tax asset	$ -	$ -

A valuation allowance is provided to reduce deferred tax assets to a level which, more likely than not, will be realized. Due to the initial losses recognized during the first three years of operations, a valuation allowance has been recorded for all of the Company's deferred tax assets. The need for this valuation allowance will be periodically reviewed and benefits will be recognized when they are determined to be realizable.

The provision for income taxes differs from amounts computed by applying the statutory Federal income tax rate to income before income taxes. The effects of these differences are as follows:

	Years Ended December 31,			
	2008		2007	
	Amount	Rate %	Amount	Rate %
Federal income tax (benefit) expense, at statutory rate	$ (577,000)	(34.0)	$ 285,000	34.0
State franchise tax (benefit) expense, net of Federal tax (benefit) expense	(36,000)	(2.1)	35,000	4.1
Share-based compensation	27,000	1.6	19,000	2.2
Deferred tax valuation allowance	381,000	22.5	(231,000)	(27.5)
Tax -exempt income from life insurance policies	(38,000)	(2.2)	(36,000)	(4.3)
Other	348,000	20.4	(72,000)	(8.5)
Total income tax expense	$ 105,000	6.2	$ -	

At December 31, 2008, the Company had Federal and State net operating loss carryforwards (NOLs) of $1,262,000 and $1,866,000, respectively. The Federal NOLs expire beginning in 2024. The State NOLs expire beginning in 2014.

Status of Open Tax Years

We are subject to U.S. Federal income tax as well as California state income tax. Federal income tax returns for 2005 through 2007 and California income tax returns for 2004 through 2007 are currently open for Federal or state income tax examinations.

8. SHORT-TERM BORROWING ARRANGEMENTS

The Company had unsecured Federal Funds lines of credit totaling $9 million and $12 million with its correspondent banks at December 31, 2008 and 2007, respectively. There were no borrowings outstanding under these agreements at December 31, 2008 and 2007.

9. COMMITMENTS

Operating Leases

The Company leases its branch and its administrative offices under a noncancellable operating lease. The lease expires in 2018 and has two five-year renewal options. The Company also leases office space for a loan production office in San Carlos, California. The loan production office lease expires in 2010 and has one two-year renewal option. The Company also leases space for it's former branch and administrative office locations which expire in 2013.

The following is a schedule by years of future minimum rental payments required under operating leases and total minimum sublease rental income to be received that have initial or remaining noncancellable lease terms in excess of one year as of December 31, 2008:

Year Ending December 31,	Leases	Subleases
2009	$ 1,202,527	$ 469,286
2010	1,235,358	482,586
2011	1,256,571	496,157
2012	1,297,149	209,379
2013	1,206,360	
Thereafter	4,294,749	
	$ 10,492,714	$ 1,657,409

Rental expense included in occupancy and equipment expense totaled $815,488, $399,110, and $291,207, for the years ended December 31, 2008, 2007, and 2006, net of sublease income of $61,857 for the year ended December 31, 2008.

Management has determined that the liability for future minimum rental payments due on abandoned leased premises, reduced by the estimated sublease income to be received is not material as of December 31, 2008. The future minimum rental payments required under operating leases and estimated sublease income for these locations are included in the above schedule.

Federal Reserve Requirements

Banks are required to maintain reserves with the Federal Reserve Bank equal to a percentage of their reservable deposits. The average amount of such reserve balances required at December 31, 2008 was $1,439,000.

9. COMMITMENTS (Continued)

Financial Instruments With Off-Balance-Sheet Risk

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

The Company's exposure to credit loss in the event of nonperformance by the other party for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and standby letters of credit as it does for loans included on the balance sheet.

The following financial instruments represent off-balance-sheet credit risk:

	December 31, 2008	December 31, 2007
Commitments to extend credit	$ 85,608,223	$ 57,021,441
Standby letters of credit	$ 113,794	$ 88,647

Commitments to extend credit consist primarily of unfunded single-family residential and commercial real estate construction loans and commercial revolving lines of credit. Construction loans are established under standard underwriting guidelines and policies and are secured by deeds of trust, with disbursements made over the course of construction. Commercial revolving lines of credit have a high degree of industry diversification. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Standby letters of credit are generally secured and are issued by the Bank to guarantee the performance of a customer to a third party. The credit risk involved in issuing standby letters of credit is essentially the same as that involved in extending loans to customers. The fair value of the liability related to these standby letters of credit, which represents the fees received for issuing the guarantees, was not significant at December 31, 2008 and 2007. The Company recognizes these fees as revenue over the term of the commitment or when the commitment is used.

At December 31, 2008, most loan commitments are for real estate mortgage and commercial loans and are generally secured by real estate with a loan-to-value ratio not to exceed 80%. In addition, the majority of the Company's loan commitments have variable interest rates.

9. COMMITMENTS (Continued)

Significant Concentrations of Credit Risk

The Company grants real estate mortgage, real estate construction, commercial and consumer loans to customers in the California counties of San Mateo and Santa Clara. Although the Company has a diversified loan portfolio, a substantial portion of its portfolio is secured by commercial and residential real estate. Management believes the loans within this concentration have no more than the normal risk of collectability, however, a substantial decline in real estate values in the Company's primary market area could have an adverse impact on the collectability of these loans. Personal and business income represent the primary sources of repayment for a majority of these loans and management believes the risks presented by the concentration is further mitigated by diversification of property types within the Company's real estate portfolio and by conservative underwriting.

At December 31, 2008, in management's judgment, a concentration of loans existed in construction and real estate related loans. At that date, approximately 78.8% of the Company's loans were construction and real estate related, representing 27.8% and 51.0% of total loans, respectively.

At December 31, 2007, in management's judgment, a concentration of loans existed in construction and real estate related loans. At that date, approximately 76.0% of the Company's loans were construction and real estate related, representing 23.8% and 52.2% of total loans, respectively.

Correspondent Banking Agreements

The Company maintains funds on deposit with other federally-insured financial institutions under correspondent banking agreements. Those insured financial institutions have elected to participate in the FDIC-sponsored Transaction Account Guarantee Program. Under that program, through December 31, 2009, all noninterest-bearing transaction accounts are fully guaranteed by the FDIC for the entire amount in the account. Coverage under the Transaction Account Guarantee Program is in addition to and separate from the coverage available under the FDIC's general deposit insurance rules. This program was not in effect in 2007 and deposits over $250,000 that are now covered by insurance totaled $5,961,901 at December 31, 2008.

10. SHAREHOLDERS' EQUITY

Dividends

The Company's ability to pay cash dividends is dependent on dividends paid to it by the Bank and limited by California law. Under California law, the holders of common stock of the Company are entitled to receive dividends when and as declared by the Board of Directors, out of funds legally available, subject to certain restrictions. California General Corporation Law prohibits the Company from paying dividends on its common stock unless: (i) its retained earnings, immediately prior to the dividend payment, equals or exceeds the amount of the dividend or (ii) immediately after giving effect to the dividend, the sum of the Company's assets (exclusive of goodwill and deferred charges) would be at least equal to 125% of its liabilities (not including deferred taxes, deferred income and other deferred liabilities) and the current assets of the Company would be at least equal to its current liabilities, or, if the average of its earnings before taxes on income and before interest expense for the two preceding fiscal years was less than the average of its interest expense for the two preceding fiscal years, at least equal to 125% of its current liabilities.

10. SHAREHOLDERS' EQUITY (Continued)

Dividends (continued)

Dividends paid from the Bank to the Company are restricted under certain Federal laws and regulations governing banks. In addition, the California Financial Code restricts the total dividend payment of any bank in any one year to the lesser of (1) the bank's retained earnings or (2) the bank's net income for its last three fiscal years, less distributions made to shareholders during the same three-year period. At December 31, 2008, no amounts were free of such restrictions.

Earnings (Loss) Per Share

A reconciliation of the numerators and denominators of the basic and diluted earnings (loss) per share computations for the years ended December 31, 2008, 2007 and 2006 is shown below.

	Net (Loss) Income	Weighted Average Number of Shares Outstanding	Per Share Amount
December 31, 2008			
Basic loss per share	$ (1,802,096)	2,237,994	$ (0.81)
Effect of dilutive options			
Diluted loss per share	$ (1,802,096)	2,237,994	$ (0.81)
December 31, 2007			
Basic earnings per share	$ 838,685	1,873,107	$ 0.45
Effect of dilutive options		70,582	
Diluted earnings per share	$ 838,685	$ 1,943,689	$ 0.43
December 31, 2006			
Basic loss per share	$ (227,108)	1,856,943	$ (0.12)
Effect of dilutive options			
Diluted loss per share	$ (227,108)	1,856,943	$ (0.12)

Regulatory Capital

The Company and Bank are subject to certain regulatory capital requirements administered by the Board of Governors of the Federal Reserve System and the FDIC. Failure to meet these minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Company's consolidated financial statements. 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-

10. SHAREHOLDERS' EQUITY (Continued)

Regulatory Capital (continued)

items as calculated under regulatory accounting practices. The Company's and the Bank'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 and the Bank to maintain minimum amounts and ratios of total and Tier 1 capital to risk-weighted assets and of Tier 1 capital to average assets. Each of these components is defined in the regulations. Management believes that the Company and the Bank met all their capital adequacy requirements as of December 31, 2008 and 2007.

As of December 31, 2008 , the most recent notification from the FDIC categorized the Bank as well-capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the Bank's category. To be categorized as well capitalized, under the regulatory framework for prompt corrective actions, the Company and the Bank must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth below:

	2008		2007	
	Amount	Ratio	Amount	Ratio
Leverage Ratio				
Peninsula Bank Holding Co.	$ 22,551,100	8.7%	NA	
Minimum regulatory requirement	$ 10,397,989	4.0%		
The Private Bank of the Peninsula	$ 22,551,000	8.7%	$ 15,513,351	7.8%
Minimum requirement for "Well-Capitalized" institution	$ 12,997,486	5.0%	$ 9,953,869	5.0%
Minimum regulatory requirement	$ 10,397,989	4.0%	$ 7,963,095	4.0%
Tier 1 Risk-Based Capital Ratio				
Peninsula Bank Holding Co.	$ 22,551,100	10.2%	NA	
Minimum regulatory requirement	$ 8,846,200	4.0%		
The Private Bank of the Peninsula	$ 22,551,000	10.2%	$ 15,513,351	9.4%
Minimum requirement for "Well-Capitalized" institution	$ 13,269,300	6.0%	$ 9,920,528	6.0%
Minimum regulatory requirement	$ 8,846,200	4.0%	$ 6,613,685	4.0%
Total Risk-Based Capital Ratio				
Peninsula Bank Holding Co.	$ 25,339,100	11.5%	NA	
Minimum regulatory requirement	$ 17,692,400	8.0%		
The Private Bank of the Peninsula	$ 25,339,000	11.5%	$ 17,253,057	10.4%
Minimum requirement for "Well-Capitalized" institution	$ 22,115,500	10.0%	$ 16,534,213	10.0%
Minimum regulatory requirement	$ 17,692,400	8.0%	$ 13,227,370	8.0%

11. SHARE-BASED PAYMENT

Stock Options

Under the Company's 2008 Stock Option Plan, 780,000 shares of common stock are reserved for issuance to employees and Directors under incentive or nonstatutory agreements, of which 83,775 shares of common stock have been issued to date. The plan requires that the option price may not be less than the fair market value of the stock at the date the option is granted, and that the stock must be paid for in full at the time the option is exercised. All options expire on a date determined by the Board of Directors, but not later than five years from the date of grant. Upon grant, options vest ratably over a four year period.

A summary of option activity under the Plan for the years ended December 31, 2008 and 2007 follows:

	Number of Stock Options Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in Years)	Aggregate Intrinsic Value
Options outstanding at January 1, 2007	305,450	$ 11.69		
Options granted	188,500	$ 15.27		
Options exercised	(25,250)	$ 10.97		
Options cancelled	(21,250)	$ 12.71		
Options outstanding at December 31, 2007	447,450	$ 13.16		
Options granted	310,399	$ 13.17		
Options exercised	(22,400)	$ 10.00		
Options cancelled	(149,550)	$ 10.50		
Options outstanding at December 31, 2008	585,899	$ 13.97	3.79 years	$ -
Options vested or expected to vest at December 31, 2008	462,996	$ 14.02	3.74 years	$ -
Options exercisable at December 31, 2008	94,750	$ 14.69	2.79 years	$ -

The weighted-average grant-date fair value of options granted during 2008, 2007 and 2006 was $2.74, $3.81, and $2.92, respectively.

The total intrinsic value of options exercised in the years ended December 31, 2008, 2007 and 2006 was $38,040, $97,106 and $91,625, respectively.

Cash received from options exercised for the years ended December 31, 2008, 2007 and 2006 was $224,400, $277,043, and $66,250, respectively.

11. SHARE-BASED PAYMENT (Continued)

Stock Options (Continued)

A summary of the status of the Company's non-vested shares as of January 1, 2008 and changes during the year ended December 31, 2008, is presented below:

Non-vested Shares	Shares	Weighted Average Exercise Price
Non-vested at January 1, 2008	262,625	$ 14.96
Granted	310,399	13.17
Vested	(68,875)	14.87
Cancelled	(13,000)	15.38
Non-vested at December 31, 2008	491,149	$ 13.83

As of December 31, 2008, the unrecognized compensation cost related to non-vested stock option awards totaled $963,875. That cost is expected to be amortized on a straight-line basis over a weighted average period of 1.46 years and will be adjusted for subsequent changes in estimated forfeitures. The total fair value of vested options was $315,032 for the year ended December 31, 2008.

12. EMPLOYEE RETIREMENT PLAN

The Bank adopted The Private Bank of the Peninsula 401(k) Profit Sharing Plan and Trust, effective October 28, 2003. All employees 21 years of age or older become eligible to participate in the plan on the first day of the month following 30 days of employment with the Bank. Eligible employees may elect to make tax deferred contributions of their salary up to the maximum amount allowed by law. The Bank may make additional contributions to the plan at the discretion of the Board of Directors. Bank contributions vest at a rate of 20% annually for all employees. Bank contributions for the years ended December 31, 2008, 2007 and 2006 totaled $25,145, $18,972 and $17,099, respectively.

13. RELATED PARTY TRANSACTIONS

During the normal course of business, the Company enters into transactions with related parties, including Directors and officers. These transactions include borrowings from the Company with substantially the same terms, including rates and collateral, as loans to unrelated parties. The following is a summary of the aggregate activity involving related party borrowers during 2008:

Balance, January 1, 2008	$ 4,068,422
Disbursements	1,704,289
Amounts repaid	(33,711)
Balance, December 31, 2008	$ 5,739,000
Undisbursed commitments to related parties, December 31, 2008	$ 2,620,328

14. OTHER EXPENSES

Other expenses for the years ended December 31, 2008, 2007 and 2006 consisted of the following:

	2008	2007	2006
Data processing	$ 195,263	$ 173,461	$ 170,734
Advertising and marketing	170,537	128,091	117,345
Supplies and printing	49,544	42,723	67,088
Professional fees	340,321	313,487	491,783
Director's fees	137,375	-	-
Insurance and bonding	46,598	54,327	49,736
Other	620,941	511,978	409,154
Total Other Expenses	$ 1,560,579	$ 1,224,067	$ 1,305,840

15. COMPREHENSIVE INCOME

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

The Company held securities classified as available-for-sale which had unrealized gains as follows:

	Before Tax	Tax Liability	After Tax
For the Year Ended December 31, 2008			
Net unrealized holding gains	$ 70,213	$ (55,042)	$ 15,171
For the Year Ended December 31, 2007			
Net unrealized holding gains	$ 105,584	$ -	$ 105,584
For the Year Ended December 31, 2006			
Net unrealized holding gains	$ 101,058	$ -	$ 101,058

The tax liability related to unrealized holding gains during the years ended December 31, 2007 and 2006 was not significant.

16. FAIR VALUE OF FINANCIAL INSTRUMENTS

SFAS No. 107, "Disclosures about Fair Value of Financial Instruments," requires that the Company disclose the fair value of financial instruments for which it is practicable to estimate that value. Although management uses its best judgment in estimating fair value, there are inherent weaknesses in any estimates that are made at a discrete point in time based on relevant market data, information about the financial instruments, and other factors. Estimates of fair value of instruments without quoted market prices are subjective in nature and involve various assumptions and estimates that are matters of judgment. Changes in the assumptions used could significantly affect these estimates.

Methods and assumptions used to estimate the fair value of each major classification of financial instruments were:

Cash and cash equivalents: The current carrying amount approximates estimated fair value.

Available-for-sale investment securities and interest-bearing deposits in other banks: For available-for-sale investment securities and interest-bearing deposits in other banks, fair values are based on quoted market prices, where available. If quoted market prices are not available, fair values are estimated using quoted market prices for similar securities and deposits and indications of value provided by brokers.

Loans: The carrying amount of loans is net of deferred loan fees or costs and the allowance for loan losses. To estimate the fair value of the Company's loans, which are primarily adjustable rate and intermediate fixed rate commercial real estate and construction loans, the Company segments loans into categories based on maturity date.

Investments in life insurance: Both the carrying amount and the fair value of investments in life insurance reflect the total cash surrender value of each policy.

Customer deposits: The fair value of deposits with no stated term such as demand deposit accounts, NOW accounts, MMDA accounts and savings accounts is the carrying amount reported on the consolidated balance sheet. The intangible value of long term relationships with depositors is not taken into account in estimating the fair values disclosed. Management believes that the Bank's non-term accounts, as a continuing source of less costly funds, provide significant additional value to the Bank that is not reflected below. The fair value of deposits with a stated maturity is based on the present value of contractual cash flows discounted by the replacement rates for securities with similar remaining maturities.

Commitments to extend credit: The majority of the Bank's commitments to extend credit carry current market interest rates if converted to loans. Because these commitments are generally unassignable by either the Bank or the borrower, they have value only to the Bank and the borrower. The estimated fair value of the Bank's commitments to extend credit, including letters of credit, approximates the recorded deferred fee amounts and was not material at December 31, 2008 or 2007.

16. FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

	December 31, 2008		December 31, 2007	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(In thousands)			
Financial assets:				
Cash and due from banks	$ 38,386	$ 38,386	$ 7,631	$ 7,631
Federal funds sold	4,945	4,945	16,890	16,890
Interest-bearing deposits in other banks	15,765	15,765	4,845	4,845
Available-for-sale investment securities	8,138	8,138	22,066	22,066
Loans	198,137	203,488	144,254	145,426
Bank owned life insurance	2,991	2,991	2,881	2,881
Accrued interest receivable	1,104	1,104	904	904
Financial liabilities:				
Deposits	$ 247,998	$ 247,908	$ 184,217	$ 183,962
Accrued interest payable	44	44	234	234

17. FAIR VALUE MEASUREMENTS

On January 1, 2008, the Company adopted Financial Accounting standards Board (FASB) Statement No. 157 (SFAS 157), Fair Value Measurements. SFAS 157 defines fair value, establishes a framework for measuring fair value under accounting principles generally accepted in the United State of America (GAAP) and expands disclosures about fair value measurements. Upon adoption of SFAS No. 157 there was no cumulative effect adjustment to beginning retained earnings and no impact on the financial statements in the 12 month period ended December 31, 2008.

In accordance with SFAS No. 157, the Company groups it assets and liabilities measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. Valuations within these levels are based upon:

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

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

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

17. FAIR VALUE MEASUREMENTS (Continued)

Assets Recorded at Fair Value

The following tables present information about the company's assets and liabilities measured at fair value on a recurring and nonrecurring basis as of December 31, 2008:

Recurring Basis

The Company is required or permitted to record the following assets at fair value on a recurring basis under other accounting pronouncements.

Description	Fair Value	Level 1	Level 2	Level 3
Available-for-sale securities	$ 8,138,000		$ 8,138,000	

The following methods were used to estimate the fair value of each class of financial instruments above:

Securities - Fair values for available-for-sale investment securities are based on quoted market prices or quoted market prices for similar securities.

Non-recurring Basis

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

Description	Fair Value	Level 1	Level 2	Level 3
Impaired loans	$ 3,396,000			$ 3,396,000

The fair value of impaired loans is based on the fair value of the collateral for all collateral dependent loans and for other impaired loans is estimated using a discounted cash flow model. Impaired loans were determined to be collateral dependent and categorized as Level 3 due to ongoing real estate market conditions resulting in inactive market data, which in turn required the use of unobservable inputs and assumptions in fair value measurements.

Impaired Loans - The fair value of impaired loans is based on the fair value of the collateral for all collateral dependent loans and for other impaired loans is estimated using a discounted cash flow model.

Liabilities - The Company did not identify any liabilities that are required to be presented at fair value.

18. PARTICIPATION IN TARP PROGRAM

On January 30, 2009, the Company entered into a Letter Agreement (the "Purchase Agreement") with the United States Department of the Treasury ("Treasury"), pursuant to which the Company issued and sold 6,000 shares of the Company's Fixed Rate Cumulative Perpetual Preferred Stock, Series A (the "Series A Preferred Stock") and (ii) a warrant (the "Warrant") to purchase 81,670 shares of the Company's common stock, no par value (the "Common Stock"), for an aggregate purchase price of $6 million in cash.

The Series A Preferred Stock will qualify as Tier 1 capital and will pay cumulative dividends quarterly at a rate of 5% per annum for the first five years, and 9% per annum thereafter. The Series A Preferred Stock may be redeemed by the Company after three years. Prior to the end of three years, the Series A Preferred Stock may be redeemed by the Company only with proceeds from the sale of qualifying equity securities of the Company (a "Qualified Equity Offering").

The Warrant has a 10-year term and is immediately exercisable upon its issuance, with an exercise price, subject to antidilution adjustments, equal to $11.02 per share of the Common Stock. At December 31, 2008, the Warrant has an intrinsic value of $161,536.

If the Company receives aggregate gross cash proceeds of not less than $1,500,000 from Qualified Equity Offerings on or prior to December 31, 2009, the number of shares of Common Stock issuable pursuant to Treasury's exercise of the Warrant will be reduced by one half of the original number of shares, taking into account all adjustments, underlying the Warrant. Pursuant to the Purchase Agreement, Treasury has agreed not to exercise voting power with respect to any shares of Common Stock issued upon exercise of the Warrant.

The Series A Preferred Stock and the Warrant were issued in a private placement exempt from registration pursuant to Section 4(2) of the Securities Act of 1933, as amended. The Company has agreed to register the Series A Preferred Stock, the Warrant, and the shares of Common Stock underlying the Warrant (the "Warrant Shares"), if any, as soon as practicable (but not later than 30 days) after the date of the issuance of the Series A Preferred Stock and the Warrant. Neither the Series A Preferred Stock nor the Warrant will be subject to any contractual restrictions on transfer, except that Treasury may only transfer or exercise an aggregate of one-half of the Warrant Shares prior to the earlier of the redemption of 100% of the shares of Series A Preferred Stock or December 31, 2009.

The Series A Preferred Stock shall be non-voting, other than class voting rights on (i) any authorization or issuance of shares ranking senior to the Series A Preferred Stock, (ii) any amendment to the rights of the Series A Preferred Stock, or (iii) any merger, exchange or similar transaction which would adversely affect the rights of the Series A Preferred Stock.

If dividends on the Series A Preferred Stock are not paid in full for six dividend periods, whether or not consecutive, the holders of the Series A Preferred Stock will have the right to elect two directors. The right to elect directors will end when full dividends have been paid for four consecutive dividend periods.

18. PARTICIPATION IN TARP PROGRAM (continued)

In the Purchase Agreement, the Company agreed that, until such time as Treasury ceases to own any debt or equity securities of the Company acquired pursuant to the Purchase Agreement, the Company will take all necessary action to ensure that its benefit plans with respect to its senior executive officers comply with Section 111(b) of the Emergency Economic Stabilization Act of 2008 (the "EESA") as implemented by any guidance or regulation under the EESA that has been issued and is in effect as of the date of issuance of the Series A Preferred Stock and the Warrant, and has agreed to not adopt any benefit plans with respect to, or which cover, its senior executive officers that do not comply with the EESA, and the applicable executives have consented to the foregoing. Furthermore, the Purchase Agreement allows Treasury to unilaterally amend the terms of the agreement.

With respect to dividends on the Company's common stock and preferred stock issues that are subordinate to the Treasury's position, Treasury's consent shall be required for any increase in common dividends per share until the third anniversary of the date of its investment unless prior to such third anniversary the Series A Preferred Stock is redeemed in whole or the Treasury has transferred all of the Senior Preferred Series A Preferred Stock to third parties. Furthermore, for as long as any Series A Preferred Stock is outstanding, no dividends may be declared or paid on junior preferred shares, preferred shares ranking pari passu with the Series A Preferred Stock, or common shares (other than in the case of pari passu preferred shares, dividends on a pro rata basis with the Series A Preferred Stock), nor may the Company repurchase or redeem any junior preferred shares, preferred shares ranking pari passu with the Series A Preferred Stock or common shares, unless all accrued and unpaid dividends for all past dividend periods on the Series A Preferred Stock are fully paid.

The Company allocated the proceeds received between the Series A Preferred Stock and the Warrant based on the estimated relative fair value of each. The fair value of the Warrant was estimated based on a Black-Scholes-Merton model and totaled $776,802. The discount recorded on the Series A Preferred Stock will be amortized on the level-yield method over 4 years.

19. PARENT ONLY CONDENSED FINANCIAL STATEMENTS

CONDENSED BALANCE SHEET
December 31, 2008

	2008
ASSETS	
Cash and cash equivalents	$ 100
Investment in subsidiary	22,633,430
Total assets	$ 22,633,530
SHAREHOLDERS' EQUITY	
Common stock	$ 27,428,052
Additional paid-in capital	817,904
Accumulated deficit	(5,694,990)
Accumulated other comprehensive loss, net of taxes	82,564
Total shareholders' equity	$ 22,633,530

CONDENSED STATEMENT OF INCOME
For the Year Ended December 31, 2008

Equity in undistributed net loss of subsidiary	$ (1,802,096)
Net loss	$ (1,802,096)

19. PARENT ONLY CONDENSED FINANCIAL STATEMENTS (continued)

CONDENSED STATEMENT OF CASH FLOWS
For the Year Ended December 31, 2008

	2008
Cash flows from operating activities:	
Net loss	$ (1,802,096)
Adjustments to reconcile net loss to net cash provided by operating activities:	
Undistributed net income of subsidiary	1,802,096
Net cash provided by operating activities	-
Cash flows used in investing activities:	
Investment in subsidiary	(8,570,384)
Cash flows from financing activities:	
Proceeds from stock offering	8,346,484
Proceeds from exercise of stock options	224,000
Net cash provided by financing activities	8,570,484
Increase in cash and cash equivalents	100
Cash and cash equivalents at beginning of period	-
Cash and cash equivalents at end of year	$ 100