2013
Annual Report

Lighthouse
Bank

Lighthouse Bank

Lighthouse Bank is a locally owned and operated independent bank serving Santa Cruz County. Our Bank was founded in October 2007 by approximately 350 local residents, professionals and small business owners. Our core business operations are conducted entirely in Santa Cruz County and we are committed to success, driven by the economic health and prosperity of our community and local ownership.

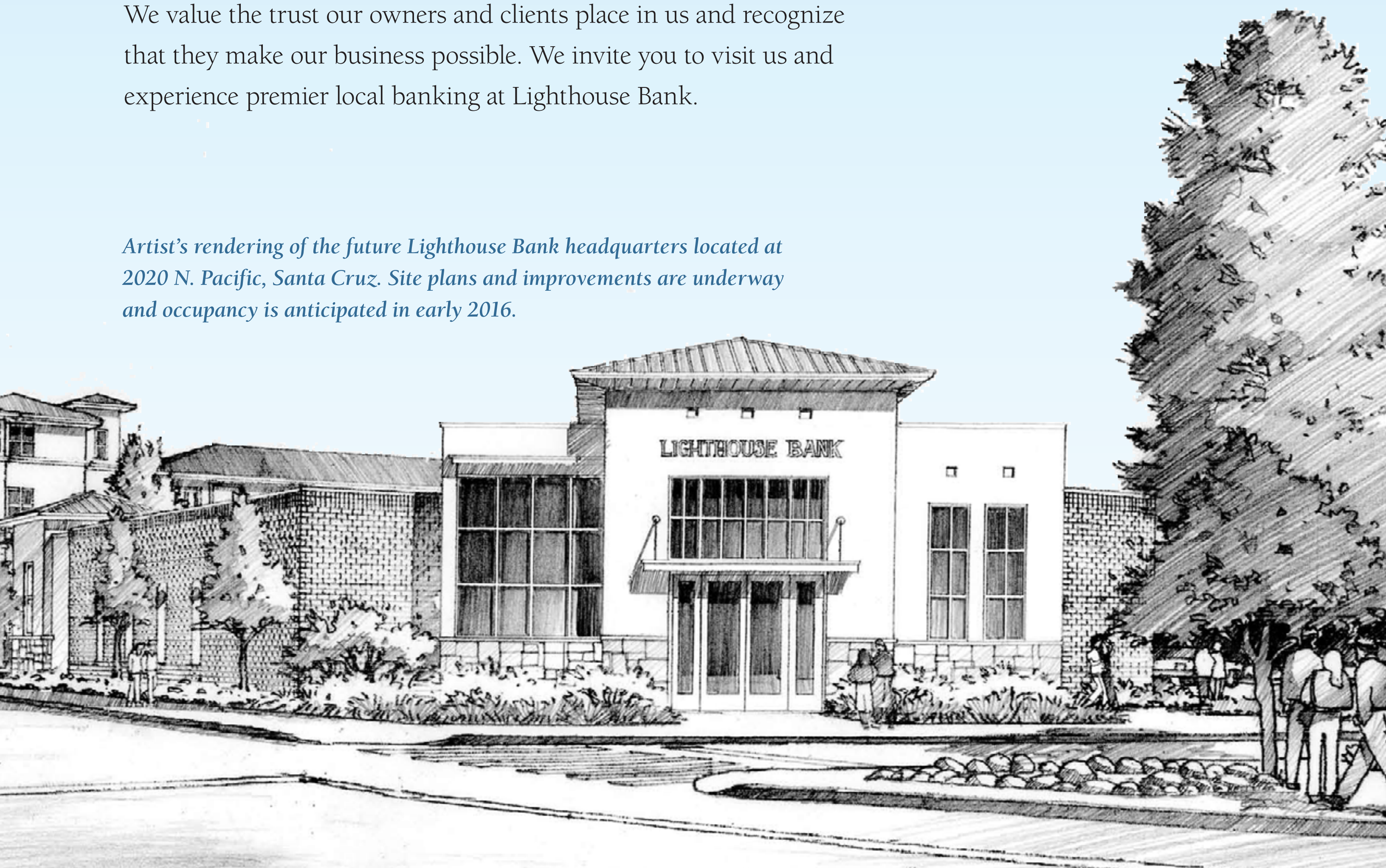
Lighthouse Bank offers a full array of loan and deposit products to professionals, small to medium-sized businesses and non-profit organizations in our community. We specialize in developing relationships that are tailored to meet the individual needs of each client. Our local headquarters and management give us the ability to respond to your needs quickly. Simply put, we believe in consistently delivering competitive products with a level of personalized, professional and highly-responsive service that is unmatched.

We value the trust our owners and clients place in us and recognize that they make our business possible. We invite you to visit us and experience premier local banking at Lighthouse Bank.

Our Mission Statement

Lighthouse Bank is committed to providing superior personalized banking products and services in Santa Cruz County. We are dedicated to creating financial benefit for our clients, professional growth for our employees and financial prosperity for our owners and community.

Artist's rendering of the future Lighthouse Bank headquarters located at 2020 N. Pacific, Santa Cruz. Site plans and improvements are underway and occupancy is anticipated in early 2016.



A Letter To Our Owners

To our Owners, Employees, Clients and Community,

On behalf of the Board of Directors and Management of Lighthouse Bank, we present our financial results for the fiscal year ended December 31, 2013.

John C. Burroughs
Chairman of the Board

Richard G. Hofstetter
President and CEO

2013 was a year of both transformation and continuing records for Lighthouse Bank. The Bank's $2.3 million in net income for the year represented a 26% increase over the $1.8 million earned in 2012 and a 63% increase over our 2011 earnings of $1.4 million. While gross loans increased by only a modest 5%, during the year, credit quality remained extraordinarily high. The Bank experienced no loan losses during 2013 and had no loans more than 30 days past due during any reporting period in the year. As a result, it was not necessary for the Bank to add to its loan loss reserve, which, at 2.78% of gross loans, was already well above norms for the industry.

In order to generate higher loan growth, significant changes were made to the Bank's Lending Group during the 2nd half of 2013. Our lending group expanded with the addition of individuals who brought with them a breadth of credit knowledge and underwriting experience. We believe these changes will continue to enhance our lending ability going forward. Additionally, the Bank is actively investigating expansion into contiguous markets and we anticipate several more lending group additions to accommodate planned business growth as we move through 2014.

We are now beginning our 7th year of operations and supported by a strong earnings history, Lighthouse Bank entered into contract to purchase the property located at 2020 North Pacific Avenue in mid 2013. This location is in the heart of the downtown Santa Cruz and will ultimately serve as the Bank's headquarters. Presently, we are working on plans for the significant expansion and renovation of the site, with project completion and occupancy estimated in early 2016. The purchase transaction closed on January 31, 2014 and our ownership decision was reflective of the importance the Bank places on true community reinvestment. In addition, the site will provide approximately 50% more space than our current facility, with occupancy costs expected to be only modestly higher than we presently experience.

Another milestone during the year was the 5% stock dividend granted during the first quarter. This was the second stock dividend granted by the Bank in just over a year. Owners who acquired our stock in the initial public offering now have an adjusted cost basis of $8.66 a share vs. the Bank's book value of $10.68, at December 31, 2013. The closing stock price on February 28, 2014 was $11.00/share.

As always, we would like to thank our owners, clients, staff and friends for their ongoing support as we strive to be an increasingly positive influence in our community. Your advocacy and trust are greatly appreciated and have been essential contributors to our ongoing success.

Please join us at our annual owners meeting at 4:00 P.M. on Thursday, May 22, 2014 at the Santa Cruz Museum of Art and History at the McPherson Center.

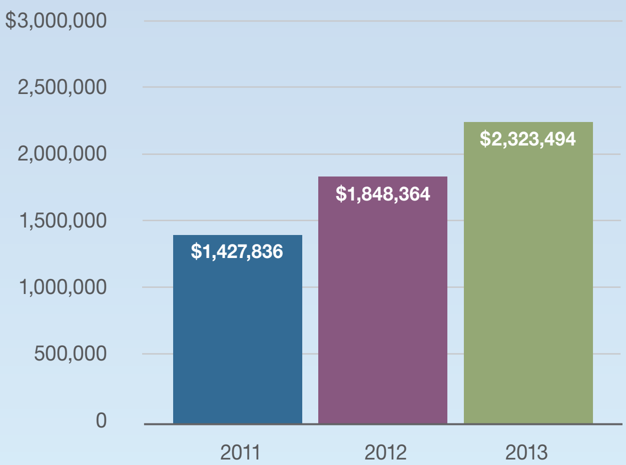
Sincerely,

John C. Burroughs
Chairman of the Board

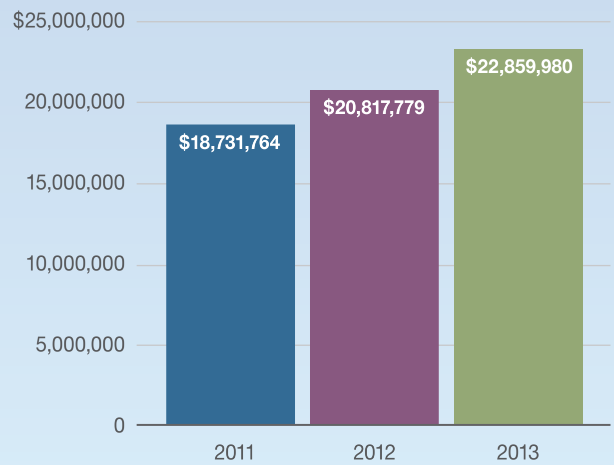
Richard G. Hofstetter
President and CEO

Financial Summary

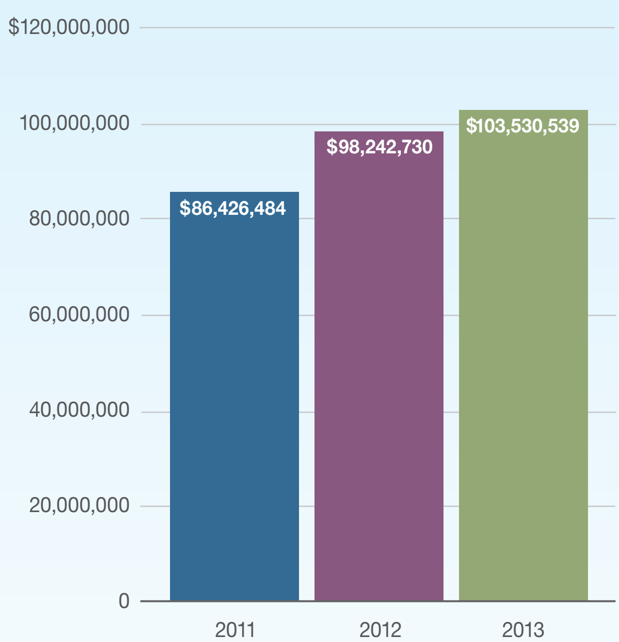
Net Income After Tax



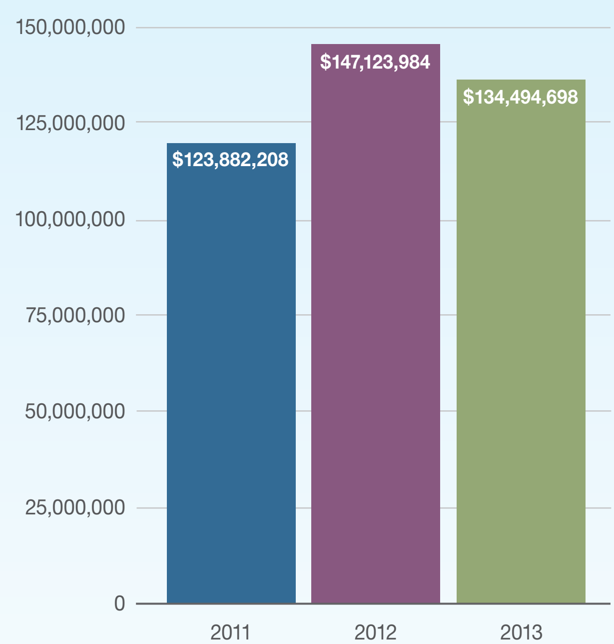
Total Shareholders' Equity



Total Gross Loans



Total Deposits



Vavrinek, Trine, Day & Co., LLP
Certified Public Accountants

VALUE THE DIFFERENCE

INDEPENDENT AUDITOR'S REPORT

Board of Directors
Lighthouse Bank

We have audited the accompanying financial statements of Lighthouse Bank, which are comprised of the statements of condition as of December 31, 2013 and 2012, and the related statements of operations, comprehensive income, changes in shareholders' equity and cash flows for each of the years in the three-year period ended December 31, 2013, and the related notes to the financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Auditor's Responsibility

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Lighthouse Bank as of December 31, 2013 and 2012, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2013, in accordance with accounting principles generally accepted in the United States of America.

Vavrinek Trine Day + Co. LLP

Palo Alto, CA
March 19, 2014

260 Sheridan Avenue, Suite 440 Palo Alto, CA 94306 Tel: 650.462.0400 Fax: 650.462.0500 www.vtdcpa.com
FRESNO ◆ LAGUNA HILLS ◆ PALO ALTO ◆ PLEASANTON ◆ RANCHO CUCAMONGA

Statements of Condition

	December 31,	
	2013	2012
Assets		
Cash and due from banks	$ 4,579,474	$ 33,714,059
Federal funds sold	–	860,000
Total cash and cash equivalents	4,579,474	34,574,059
Interest-bearing deposits in other financial institutions	31,430,826	17,006,673
Investment securities:		
Securities held to maturity	7,760,636	–
Securities available-for-sale, at estimated fair value	6,414,050	14,893,712
Total investment securities	14,174,686	14,893,712
Loans receivable:		
Gross loans	103,530,539	98,242,730
Less deferred loan fees, net of costs	579,454	533,934
Less reserve for loan losses	2,874,031	2,863,302
Net loans	100,077,054	94,845,494
Premises and equipment, net	103,675	27,438
Accrued interest receivable	358,052	345,290
Federal Home Loan Bank and bankers' bank stock, at cost	825,752	730,452
Other real estate owned	348,750	370,000
Other assets	6,076,257	5,972,052
Total Assets	$ 157,974,526	$ 168,765,170
Liabilities and Shareholders' Equity		
Liabilities:		
Deposits:		
Noninterest-bearing demand deposits	$ 30,290,175	$ 37,314,565
Interest-bearing demand deposits	8,493,178	7,900,787
Savings and money market deposits	66,715,753	70,505,592
Time deposits	28,995,592	31,403,040
Total deposits	134,494,698	147,123,984
Other liabilities:		
Accrued interest payable	9,578	12,320
Other liabilities	611,270	811,087
Total liabilities	135,115,546	147,947,391
Shareholders' Equity:		
Common stock, no par value, 10,000,000 shares authorized: issued and outstanding; 2,140,157 shares at December 31, 2013 and December 31, 2012	21,138,517	21,138,517
Additional paid-in-capital	1,179,338	1,120,447
Retained earnings (accumulated deficit)	548,445	(1,775,049)
Accumulated other comprehensive income	(7,320)	333,864
Total shareholders' equity	22,858,980	20,817,779
Total Liabilities and Shareholders' Equity	$ 157,974,526	$ 168,765,170

See accompanying notes to the Financial Statements

Statements of Operations

	Year Ended December 31,		
	2013	2012	2011
Interest Income:			
Interest and fees on loans	$7,044,668	$6,556,092	$5,846,845
Investment securities	483,181	482,279	323,924
Federal funds sold and other interest income	36,345	64,640	43,064
Total interest income	7,564,194	7,103,011	6,213,833
Interest Expense:			
Deposits and other borrowed funds	427,030	579,993	641,952
Net interest income before provision for loan losses	7,137,164	6,523,018	5,571,881
Provision for loan losses	–	238,000	930,000
Net interest income after provision for loan losses	7,137,164	6,285,018	4,641,881
Non-Interest Income:			
Service charges on deposit accounts	123,714	145,916	120,605
Other non-interest income	224,603	206,730	146,149
Total non-interest income	348,317	352,646	266,754
Non-Interest Expense:			
Salaries and employee benefits	2,508,832	2,233,413	2,126,370
Occupancy	190,927	235,955	259,000
Furniture and equipment	180,378	192,806	190,983
Marketing and business development	65,454	57,207	52,868
Item and data processing	188,124	147,916	159,656
Professional services	159,204	139,145	166,461
Other operating expenses	494,186	621,047	614,694
Total non-interest expense	3,787,105	3,627,489	3,570,032
Income before income taxes	3,698,376	3,010,175	1,338,603
Income tax expense (benefit)	1,374,882	1,161,811	(89,233)
Net income	$2,323,494	$1,848,364	$ 1,427,836
Earnings per share:			
Basic	$ 1.09	$ 0.86	$ 0.67
Diluted	$ 1.06	$ 0.85	$ 0.67

See accompanying notes to the Financial Statements

Statements of Comprehensive Income

	Year Ended December 31,		
	2013	2012	2011
Net income	$ 2,323,494	$ 1,848,364	$ 1,427,836
Other comprehensive income:			
Unrealized gains on securities:			
Unrealized holding gains (losses) arising during period	(341,184)	223,928	4,156
Plus: reclassification adjustment for losses included in net income	–	1,599	–
Other comprehensive income (loss):	(341,184)	225,527	4,156
Comprehensive income	$ 1,982,310	$ 2,073,891	$ 1,431,992

Statement of Shareholders' Equity

For the three years ended December 31, 2013

	Common Shares	Amount	Additional Paid-In Capital	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Income	Total Shareholders' Equity
Balance at January 1, 2011	1,853,028	$18,484,627	$ 1,098,165	$ (2,397,297)	$ 104,181	$ 17,289,676
Stock-based compensation	–	–	10,158	–	–	10,158
10% stock dividend	185,296	1,693,605	–	(1,693,667)	–	(62)
Net income	–	–	–	1,427,836	–	1,427,836
Unrealized gain on securities available-for-sale	–	–	–	–	4,156	4,156
Balance at December 31, 2011	2,038,324	20,178,232	1,108,323	(2,663,128)	108,337	18,731,764
Stock-based compensation	–	–	12,124	–	–	12,124
5% stock dividend	101,833	960,285	–	(960,285)	–	–
Net income	–	–	–	1,848,364	–	1,848,364
Unrealized gain on securities available-for-sale	–	–	–	–	225,527	225,527
Balance at December 31, 2012	2,140,157	21,138,517	1,120,447	(1,775,049)	333,864	20,817,779
Stock-based compensation	–	–	58,891	–	–	58,891
Net income	–	–	–	2,323,494	–	2,323,494
Unrealized (loss) on securities available-for-sale	–	–	–	–	(341,184)	(341,184)
Balance at December 31, 2013	2,140,157	$ 21,138,517	$ 1,179,338	$ 548,445	$ (7,320)	$ 22,858,980

See accompanying notes to the Financial Statements

Statements of Cash Flows

	Year Ended December 31,		
	2013	2012	2011
Operating Activities:			
Net income	$ 2,323,494	$ 1,848,364	$ 1,427,836
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization of premises and equipment	37,472	109,410	138,632
Provision for loan losses	–	238,000	930,000
Deferred income tax expense (benefit)	12,468	13,000	(1,199,000)
Net amortization/accretion of investment discounts and premiums	74,270	91,709	4,353
Increase in deferred loan fees, net of costs	45,520	55,401	73,315
Bank Owned Life Insurance income	(145,854)	(123,688)	–
Stock-based compensation	58,891	12,124	10,158
Gain on sale of equipment	(250)	–	–
Loss on disposal of equipment	–	–	1,744
Loss on sale of AFS securities	–	1,599	–
Gain on sale of OREO	–	–	(89,644)
Writedown on foreclosed assets	21,250	26,000	80,680
Net (increase) decrease in:			
Accrued interest receivable	(12,762)	(15,695)	(8,814)
Other assets	29,181	54,419	100,396
Net increase (decrease) in:			
Accrued interest payable	(2,742)	380	(10)
Other liabilities	(199,817)	292,686	169,228
Net cash provided by operating activities	2,241,121	2,603,709	1,638,874
Investing Activities:			
Investment securities:			
Principal repayments	1,652,913	1,890,669	728,600
Purchases	(1,349,341)	(13,014,369)	(5,115,676)
Sales	–	3,468,957	–
Purchase of Federal Home Loan Bank stock	(95,300)	(133,900)	(11,400)
Purchase of bankers' bank stock	–	(1,955)	(1,825)
Purchase of Bank Owned Life Insurance	–	(4,000,000)	–
Net (increase) decrease in time deposits with other banks	(14,423,359)	11,275,000	(3,581,000)
Net (increase) in other interest-bearing deposits with other banks	(794)	(868)	(1,231)
Net (increase) in loans	(5,277,080)	(12,045,944)	(17,241,425)
Purchase of premises and equipment	(113,459)	(14,004)	(6,205)
Proceeds from sale of OREO	–	–	2,161,208
Net cash used in investing activities	(19,606,420)	(12,576,414)	(23,068,954)
Financing Activities:			
Increase (decrease) in:			
Demand deposits	(6,431,999)	3,715,321	13,718,112
Savings and money market deposits	(3,789,839)	16,777,959	7,558,765
Time deposits	(2,407,448)	2,748,496	6,426,501
Other borrowings	–	–	(3,000,000)
Net cash provided (used) by financing activities	(12,629,286)	23,241,776	24,703,378
Net increase (decrease) in cash and cash equivalents	(29,994,585)	13,269,071	3,273,298
Cash and cash equivalents at beginning of period	34,574,059	21,304,988	18,031,690
Cash and cash equivalents at end of period	$ 4,579,474	$34,574,059	$ 21,304,988
Supplemental Disclosures of Cash Flow Information			
Total interest paid	$ 429,772	$ 579,613	$ 641,962
Total income taxes paid	$ 1,635,121	$ 1,137,577	$ 986,000

See accompanying notes to the Financial Statements

Note 1. Summary of Significant Accounting Policies

Description of the Business — Lighthouse Bank (the Bank) is a California state chartered bank which offers a full range of commercial and personal banking services to residents and businesses in Santa Cruz County, California, through its office in Santa Cruz, California. The Bank was incorporated on June 13, 2007 as Lighthouse Bank (In Organization) and commenced banking operations on October 29, 2007 (inception), upon receipt of final approval from the California Department of Business Oversight and the issuance of deposit insurance by the Federal Deposit Insurance Corporation. The Bank is subject to competition from other financial institutions. Additionally, the Bank is subject to regulations by the above referenced regulatory agencies and undergoes periodic examinations by those agencies.

The majority of the Bank's business is done with customers located in Northern California, specifically in Santa Cruz and adjacent counties. The Bank has 209 credit arrangements that are collateralized by real estate. Generally, the Bank maintains loan-to-value ratios no greater than 70 percent on commercial and multi-family real estate loans and no greater than 70 percent on single-family residential real estate loans. At December 31, 2013, the Bank had loans outstanding of approximately $99,496,000 that were collateralized by real estate. There were no other significant loan concentrations.

Subsequent Events — The Bank has evaluated subsequent events for recognition and disclosure through March 19, 2014, which is the date the financial statements were available to be issued.

Cash and Cash Equivalents — For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, federal funds sold and highly liquid debt instruments with an original maturity of 90 days or less. The Bank had a net cash reserve requirement of $623,000 and $768,000 at December 31, 2013, and December 31, 2012, respectively.

Use of Estimates in the Preparation of Financial Statements — The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, 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.

Investment Securities — Marketable investment securities have consisted of U.S. Government Agency, Agency mortgage-backed securities, and bank-qualified municipal securities. At the time of purchase, the Bank designates securities as either "held-to-maturity" or "available-for-sale" based on its investment objectives, operational needs and intent. The Bank does not engage in securities trading activities.

Held-to-maturity securities are recorded at amortized cost, adjusted for amortization or accretion of premiums or discounts. Available-for-sale securities are recorded at fair value with unrealized holding gains and losses, net of the related tax effect, reported as a separate component of shareholders' equity until realized. During the year ended December 31, 2013, the Bank transferred municipal securities in the amount of $6,429,894 from available-for-sale to held-to-maturity. Premiums and discounts are amortized or accreted over the life of the related security as an adjustment to yield using the effective interest method. Dividend and interest income are recognized on an accrual basis. Realized gains and losses for securities classified as available-for-sale and held-to-maturity are included in earnings and are derived using the specific identification method for determining the cost of securities sold.

Management evaluates securities for other-than-temporary impairment ("OTTI") on at least a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. For securities in an unrealized loss position, management considers the extent and duration of the unrealized loss, and the financial condition and near-term prospects of the issuer. Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows; OTTI related to credit loss, which must be recognized in the income statement and; OTTI related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis. For equity securities, the entire amount of impairment is recognized through earnings.

Loans — Loans are stated at the amount of unpaid principal, net of deferred fees, and reduced by an allowance for loan losses. Accrual of interest is discontinued on loans which are more than 90 days delinquent or when Management believes, after considering economic and business conditions and collection efforts, that the borrower's financial condition is such that collection of interest is doubtful unless the loans are well-secured and in the process of collection. When a loan is placed on non-accrual status, all interest previously accrued but not collected is charged against current period income. Income on such loans is then recognized only to the extent that cash is received and where the future collection of principal is probable. Generally, a non-accrual loan will be restored to an accrual status when none of its principal and interest is past due, when prospects for future contractual payments are no longer in doubt and when the loan becomes well-secured and in the process of collection.

Non-refundable fees and estimated loan origination costs are deferred net and are amortized to income over the expected life of the loan using a method that approximates the level yield method.

Impaired Loans — The Bank considers a loan to be impaired when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement, including scheduled interest payments. Generally, the Bank identifies loans to be reported as impaired when such loans are in non-accrual status or are considered troubled debt restructurings due to the granting of a below-market rate of interest or a partial forgiveness of indebtedness on an existing loan. Any allowance on impaired loans is generally based on one of three methods. 1) present value of expected future cash flows discounted at the loan's effective interest rate or, 2) as a practical expedient, at the loan's observable market price or 3) the fair value of the collateral if the loan is collateral dependent. Income recognition on impaired loans is consistent with the policy for income recognition on non-accrual loans described above.

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 Bank's service area.

Loan losses are charged against the allowance when Management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged off. Amounts are charged-off when available information confirms that specific loans or portions thereof, are uncollectible. This methodology for determining charge-offs is consistently applied to each segment.

The allowance consists of specific and general reserves. Specific reserves relate to loans that are individually classified as impaired. A loan is impaired when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement. Factors considered in determining impairment include payment status, collateral value and the probability of collecting all amounts when due. Loans, for which the terms have been modified resulting in a concession, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and are also classified as impaired.

Generally, large balance non-homogeneous loans are individually evaluated for impairment. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at either the present value of estimated future cash flows using the loan's effective interest rate at inception or at the fair value of collateral if repayment is expected solely from the collateral. Large groups of smaller balance homogeneous loans, such as consumer and residential real estate loans, are collectively evaluated for impairment.

Management believes that the allowance for loan losses is adequate. While Management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in economic conditions. In addition, various regulatory agencies, as an integral part of their examination process, periodically review Bank's allowance for loan losses. Such agencies may require the Bank to recognize additions to the allowance based on their judgment of information available to them at the time of their examination.

Premises & Equipment — Premises and equipment are stated at cost less accumulated depreciation and amortization and include additions that materially extend the useful lives of existing premises and equipment. All other maintenance and repair expenditures are expensed as incurred.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, three to five years, and are expensed to non-interest expense. Leasehold improvements are amortized over the initial term of the lease.

Federal Home Loan Bank Stock — The Bank is a member of the FHLB system. Members are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. FHLB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment based on the ultimate recovery of par value. Both cash and stock dividends are reported as income.

Other Real Estate Owned — Other real estate owned represents real estate acquired through foreclosure and is carried at the lower of the recorded investment on the property or its fair value. Prior to foreclosure, the value of the underlying loan is written down to the fair market value of the real estate to be acquired by a charge to the allowance for credit losses, if necessary. Any subsequent write-downs are charged against operating expenses. Operating expenses of such properties, net of related income, are included in other expenses.

Income Taxes — Deferred income taxes are computed using the asset and liability method, which recognizes a liability or asset representing the tax effects, based on current tax law, of future deductible or taxable amounts attributable to events that have been recognized in the financial statements. A valuation allowance is established to reduce the deferred tax asset to the level at which it is “more likely than not” that the tax asset or benefits will be realized. Realization of tax benefits of deductible temporary differences and operating loss carry forwards depends on having sufficient taxable income of an appropriate character within the carry forward periods.

The Bank has adopted guidance issued by the Financial Accounting Standards Board (“FASB”) that clarifies the accounting for uncertainty in tax positions taken or expected to be taken on a tax return and provides that the tax effects from an uncertain tax position can be recognized in the financial statements only if, based on its merits, the position is more likely than not to be sustained on audit by the taxing authorities. Interest and penalties related to uncertain tax positions are recorded as part of income tax expense.

This guidance has been applied to all tax positions of the Bank as of inception. The adoption of this guidance has not had a material impact on the Bank’s financial position, results of operations or cash flows for the periods presented.

Stock-Based Compensation — The Bank recognizes the cost of employee services received in exchange for awards of stock options, or other equity instruments, based on the grant-date fair value of those awards. This cost is recognized over the period which an employee is required to provide services in exchange for the award, generally the vesting period. See Note 8 for additional information on the Bank’s stock option plan.

Fair Value Measurements — Fair value is the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Current accounting guidance establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The guidance describes three levels of inputs that may be used to measure fair value:

- **Level 1**: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.
- **Level 2**: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.
- **Level 3**: Significant unobservable inputs that reflect a Bank’s own assumptions about the assumptions that market participants would use in pricing an asset or liability.

See Note 12 for more information and disclosures relating to the Bank’s fair value measurements.

Earnings (Loss) Per Share — Basic EPS excludes dilution and is computed by dividing income available to common stockholders 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 were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity. The weighted average shares outstanding have been adjusted to retroactively reflect the impact of the 10% stock dividend issued in 2011 and the 5% stock dividend issued on March 8, 2013. The weighted average shares outstanding for the basic earnings per share calculation were 2,140,157 for the years ended December 31, 2013, 2012 and 2011. The weighted average shares outstanding for diluted earnings per share for the year ended December 31, 2013 and 2012 was 2,196,918 and 2,184,853, respectively. There were no potentially dilutive securities outstanding in 2011.

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

Note 2. Investment Securities

The following table summarizes Lighthouse Bank’s securities at December 31, 2013, and December 31, 2012:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
December 31, 2013				
Securities available-for-sale:				
U.S. Agency	$ 1,000,000	$ 9,590	$ –	$ 1,009,590
U.S. Agency MBSs	5,421,370	47,017	(63,927)	5,404,460
Total securities available-for-sale	$ 6,421,370	$ 56,607	$ (63,927)	$ 6,414,050
Securities held-to-maturity:				
Municipal Securities	$ 7,760,636	$ –	$ (377,500)	$ 7,383,136
December 31, 2012				
Securities available-for-sale:				
U.S. Agency	$ 1,000,000	$ 19,240	$ –	$ 1,019,240
Municipal Securities	6,431,567	98,340	(18,041)	6,511,866
U.S. Agency MBSs	7,128,281	234,325	–	7,362,606
Total securities available-for-sale	$14,559,848	$ 351,905	$ (18,041)	$ 14,893,712

The amortized cost and estimated fair value of investment securities at December 31, 2013 and December 31, 2012 by contractual maturity are shown below, except for mortgage-backed securities and other securities which are presented in total. Expected maturities on mortgage-backed securities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Estimated Fair Value
December 31, 2013		
Due in one year or less	$ 8,032	$ 8,374
Due after one year through five years	1,382,381	1,416,789
Due after five years through ten years	2,262,551	2,172,212
Due after ten years	10,529,042	10,199,811
Total	$14,182,006	$ 13,797,186
December 31, 2012		
Due in one year or less	$ 25,184	$ 26,403
Due after one year through five years	1,049,526	1,069,302
Due after five years through ten years	2,079,993	2,166,565
Due after ten years	11,405,145	11,631,442
Total	$14,559,848	$14,893,712

Note 3. Loans

Loan maturity and rate sensitivity data of the loan portfolio at December 31, 2013 and 2012 are as follows (in thousands):

December 31, 2013	Within One Year	One to Five Years	After Five Years	Total
Loans secured by real estate, land and construction loans	$ 26,649	$ 24,124	$ 41,430	$ 92,203
Consumer and other loans	369	332	3,706	4,407
Commercial and revolving lines	5,051	1,237	633	6,921
	$ 32,069	$ 25,693	$ 45,769	$ 103,531
Loans at fixed interest rates	$ 26,268	$ 17,756	$ 33,165	$ 77,189
Loans at variable interest rates	5,801	7,937	12,604	26,342
	$ 32,069	$ 25,693	$ 45,769	$ 103,531

December 31, 2012	Within One Year	One to Five Years	After Five Years	Total
Loans secured by real estate, land and construction loans	$ 26,723	$ 12,492	$ 49,747	$ 88,962
Consumer and other loans	102	9	–	111
Commercial and revolving lines	5,129	3,598	443	9,170
	$ 31,954	$ 16,099	$ 50,190	$ 98,243
Loans at fixed interest rates	$ 25,057	$ 10,305	$ 38,538	$ 73,900
Loans at variable interest rates	6,897	5,794	11,652	24,343
	$ 31,954	$ 16,099	$ 50,190	$ 98,243

A summary of the changes in the allowance for loan losses for the years ended December 31:

	2013	2012	2011
Balance at beginning of year	$ 2,863,302	$ 2,855,000	$ 1,925,000
Provision for loan losses	–	238,000	930,000
Loan charge-offs	–	(256,686)	–
Unfunded commitment reclassification	(47,781)	(35,000)	–
Recoveries of loan charge-offs	58,510	61,988	–
Balance at year end	$ 2,874,031	$ 2,863,302	$ 2,855,000

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

December 31, 2013	Commercial Real Estate	Residential Real Estate	Commercial	Consumer	Total
Allowance for Loan Losses:					
Beginning of Year	$ 2,445,672	$ 44,696	$ 371,175	$ 1,759	$ 2,863,302
Provisions	–	–	–	–	–
Charge-offs	–	–	–	–	–
Adjustments	(27,558)	–	(20,223)	–	(47,781)
Recoveries	–	49,048	–	9,462	58,510
End of Year	$ 2,418,114	$ 93,744	$ 350,952	$ 11,221	$ 2,874,031
Reserves:					
Specific	$ 71,714	$ 13,985	$ 19,980	$ –	$ 105,679
General	2,346,400	79,759	330,972	11,221	2,768,352
	$ 2,418,114	$ 93,744	$ 350,952	$ 11,221	$ 2,874,031
Loans Evaluated for Impairment:					
Individually	$ 1,434,289	$ 139,847	$ 215,492	$ –	$ 1,789,628
Collectively	83,930,065	3,884,243	13,471,007	455,596	101,740,911
	$ 85,364,354	$ 4,024,090	$ 13,686,499	$ 455,596	$103,530,539

December 31, 2012	Commercial Real Estate	Residential Real Estate	Commercial	Consumer	Total
Allowance for Loan Losses:					
Beginning of Year	$ 2,346,323	$ 83,499	$ 425,097	$ 81	$ 2,855,000
Provisions	329,047	(38,803)	(53,922)	1,678	238,000
Charge-offs	(256,686)	–	–	–	(256,686)
Adjustments	(35,000)	–	–	–	(35,000)
Recoveries	61,988	–	–	–	61,988
End of Year	$ 2,445,672	$ 44,696	$ 371,175	$ 1,759	$ 2,863,302
Reserves:					
Specific	$ 509,366	$ –	$ 1,639	$ –	$ 511,005
General	1,936,306	44,696	369,536	1,759	2,352,297
	$ 2,445,672	$ 44,696	$ 371,175	$ 1,759	$ 2,863,302
Loans Evaluated for Impairment:					
Individually	$ 4,313,492	$ –	$ 32,783	$ –	$ 4,346,275
Collectively	75,105,461	2,458,722	16,212,943	119,329	93,896,455
	$ 79,418,953	$ 2,458,722	$ 16,245,726	$ 119,329	$ 98,242,730

The Bank categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as current financial information, historical payment experience, collateral adequacy, credit documentation, and current economic trends, among other factors. The Bank analyzes loans individually by classifying the loans as to credit risk. This analysis typically includes larger, non-homogeneous loans such as commercial real estate and commercial and industrial loans. This analysis is performed on an ongoing basis as new information is obtained. The Bank uses the following definitions for risk ratings:

Pass — Loans classified as pass include loans not meeting any of the risk ratings defined below.

Special Mention — Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date.

Substandard — Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Doubtful & Impaired — A loan is considered impaired, when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement. Additionally, all loans classified as doubtful or as troubled debt restructurings are considered impaired.

Based on the most recent analysis performed, the approximate amount of loans by risk category and class of loans is as follows as of December 31, 2013 and 2012:

December 31, 2013	Pass	Special Mention	Substandard	Doubtful & Impaired	Total
Loans:					
Construction and land	$ 20,082,780	$ 299,922	$ –	$ –	$ 20,382,702
Commercial real estate	63,847,285	1,134,367	–	–	64,981,652
Residential real estate	3,884,243	–	139,847	–	4,024,090
Commercial and industrial	11,599,102	31,384	184,108	–	11,814,594
Small Business Administration	1,871,905	–	–	–	1,871,905
Other	455,596	–	–	–	455,596
	$101,740,911	$ 1,465,673	$ 323,955	$ –	$103,530,539

December 31, 2012	Pass	Special Mention	Substandard	Doubtful & Impaired	Total
Loans:					
Construction and land	$ 12,409,341	$ 895,300	$ 382,163	$ –	$ 13,686,804
Commercial real estate	62,696,120	1,544,340	991,689	500,000	65,732,149
Residential real estate	2,458,722	–	–	–	2,458,722
Commercial and industrial	14,143,023	32,783	–	–	14,175,806
Small Business Administration	2,069,920	–	–	–	2,069,920
Other	119,329	–	–	–	119,329
	$93,896,455	$ 2,472,423	$ 1,373,852	$ 500,000	$ 98,242,730

In general, the Bank would not recognize any interest income on loans that are classified as impaired. The following is a summary of the investment in impaired loans as of December 31, 2013 and 2012, including the related allowance for loan losses and cash-basis income recognized. Also shown are loans on non-accrual and those that are past due and still accruing interest:

	As of December 31, 2013	As of December 31, 2012
Impaired Loans:		
Recorded investment in impaired loans	$ –	$ 500,000
Related allowance for loan loss	–	250,000
Average recorded investment in impaired loans	–	500,000
Interest income recognized for cash payments while impaired	–	–
Total loans on non-accrual	–	500,000
Total loans past due 90 days or more and still accruing interest	–	–

Past due and nonaccrual loans presented by loan class were as follows as of December 31, 2013 and 2012:

December 31, 2013	Still Accruing 30-89 Days Past Due	Still Accruing Over 90 Days Past Due	Nonaccrual
Commercial Real Estate:			
Construction and Land Development	$ –	$ –	$ –
Multifamily	–	–	–
Other	–	–	–
Residential Real Estate	–	–	–
Commercial	–	–	–
	$ –	$ –	$ –

December 31, 2012	Still Accruing 30-89 Days Past Due	Still Accruing Over 90 Days Past Due	Nonaccrual
Commercial Real Estate:			
Construction and Land Development	$ –	$ –	$ 500,000
Multifamily	–	–	–
Other	–	–	–
Residential Real Estate	–	–	–
Commercial	–	–	–
	$ –	$ –	$ 500,000

Note 4. Premises and Equipment

The following presents the cost of premises and equipment including leasehold improvements and the related accumulated depreciation and amortization at December 31, 2013 and December 31, 2012:

	December 31, 2013	December 31, 2012
Leasehold improvements	$ 294,469	$ 294,469
Furniture, fixtures and equipment	213,764	222,657
Software and capitalized data & item processing	222,902	145,660
Computer equipment	179,805	156,406
Automobile	20,282	20,282
Construction-in-progress	8,697	–
Total premises and equipment	939,919	839,474
Less accumulated depreciation and amortization	836,244	812,036
Premises and equipment, net	$ 103,675	$ 27,438

Depreciation and amortization expense of premises and equipment aggregated $37,472, $109,410 and $138,632 for the years ended December 31, 2013, December 31, 2012 and December 31, 2011, respectively.

Note 5. Income Taxes

The components of income tax expense (benefit) are as follows for the years ended December 31:

	2013	2012	2011
Current:			
Federal	$ 1,040,414	$ 841,587	$ 875,287
State	346,936	307,224	234,480
Total current	1,387,350	1,148,811	1,109,767
Deferred:			
Federal	(252)	(64,000)	(344,000)
State	(12,216)	77,000	(122,000)
Valuation Allowance Reversal	–	–	(733,000)
Total deferred	(12,468)	13,000	(1,199,000)
Total expense (benefit)	$ 1,374,882	$ 1,161,811	$ (89,233)

Deferred income taxes are the result of differences between income tax accounting and accounting principles generally accepted in the United States of America, with respect to income and expense recognition. The following is a summary of the components of the net deferred tax asset accounts as of December 31, 2013, 2012 and 2011:

	2013	2012	2011
Pre-opening expenses	$ 64,000	$ 71,000	$ 82,000
Stock-based compensation	164,000	164,000	164,000
OREO expenses	105,000	94,000	152,000
Loan loss reserve	1,158,000	1,158,000	1,126,000
Other	161,000	177,000	153,000
	1,652,000	1,664,000	1,677,000
Valuation allowance	–	–	–
Net deferred tax asset	$ 1,652,000	$ 1,664,000	$ 1,677,000

The following is a reconciliation of the expected federal income tax rate to the actual rate for the years ended December 31:

	2013	2012	2011
Tax at statutory federal rate	34.00%	34.00%	34.00%
State tax net of federal benefit	7.15	7.15	7.15
Deferred tax valuation allowance	–	–	(54.76)
Other	(3.95)	(2.55)	6.94
	37.2%	38.6%	(6.67)%

The Bank's Federal and State income tax returns are subject to review by Federal and State taxing authorities for the three and four year periods ending December 31, 2012, respectively.

Note 6. Time Deposits

The aggregate amount of time deposit accounts equal to or greater than $100,000 was $18,743,789 and $21,072,019 at December 31, 2013 and December 31, 2012, respectively. At December 31, 2012 the scheduled maturities for time deposits were as follows (in thousands):

Due in 2014	$ 21,838
Due in 2015	3,611
Due in 2016	1,975
Due in 2017	749
Due in 2018	822
	$ 28,995

Interest expense on time deposits of $100,000 or more was $140,829, $212,875 and $191,771 in 2013, 2012 and 2011, respectively.

Note 7. Borrowed Funds

The Bank has obtained federal funds borrowing guidance lines with its correspondent banks in an aggregate amount of $7.0 million on an unsecured basis. The only usage of these guidance lines was to successfully test their availability. Additionally, the Bank has established a secured borrowing facility with the Federal Home Loan Bank of San Francisco (FHLB). The Bank had no FHLB borrowings during the years-ended December 31, 2013, or December 31, 2012. At December 31, 2013, the Bank had a total available borrowing capacity of $40,060,118 which included $32,139,800 in secured borrowing capacity from the FHLB.

Note 8. Stock Options

The Bank has adopted a qualified stock option plan (the Plan) for employees, non-employee directors and Bank founders, under which a maximum of 555,908 shares of Bank's common stock may be issued. The Plan calls for the exercise prices of the options to be equal to or greater than the fair market value of the stock at the time of grant. Options granted to Bank founders who are not also Bank directors or Bank officers were fully vested upon the date of grant. All other options shares granted have annual vesting over the first three years of the option contract. All option contracts for founders who are not also Bank directors or Bank officers have expiration dates of ten years from the date of grant. All director and employee option contracts have expiration dates on the earlier of termination of service or 10 years from the date of grant. For all periods presented, amounts in the succeeding tables reflect the 10% stock dividend of December 5, 2011 and the 5% stock dividend of March 8, 2013.

The following is a summary of required disclosures relating to the Bank's stock option plan for the periods presented:

	Options Outstanding	Weighted Average Exercise Price
Balance at December 31, 2011	470,637	$ 8.69
Granted 2012	11,865	8.79
Exercised 2012	–	–
Cancelled 2012	(8,800)	10.11
Balance at December 31, 2012	473,702	$ 8.65
Granted 2013	100,375	10.27
Exercised 2013	–	–
Cancelled 2013	(61,863)	8.83
Balance at December 31, 2013	512,214	$ 8.95

	Options Outstanding			Options Exercisable		
	Number	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number	Weighted Average Contractual Life	Weighted Average Exercise Price
December 31, 2012:	473,702	4.90 years	$ 8.65	459,527	4.77 years	$ 8.65
December 31, 2013:	512,214	4.97 years	$ 8.95	409,774	3.82 years	$ 8.65

There was an aggregate intrinsic value of stock option awards outstanding and exercisable of $1,000,985 and $908,805, respectively, at December 31, 2013.

The number and weighted average grant date fair value of options granted is as follows for the years ended December 31, 2013, December 31, 2012 and December 31, 2011:

	Number	Weighted Average Grant Date Fair Value
2011	3,300	$2.72
2012	11,300	$4.37
2013	100,375	$2.39

The weighted average assumptions used for 2013, 2012 and 2011 in determining the fair value of options granted are as follows:

	2013	2012	2011
Expected life (yrs.)	6	6	6
Volatility	16.70%	48.31%	35.28%
Risk free rate of return	2.44%	1.72%	3.44%
Dividend yield	0.00%	0.00%	0.00%

As of December 31, 2013, there was $226,135 unrecognized stock compensation expense that will be recognized through November 30, 2016.

Note 9. 401(k) Employee Benefit Plan

All employees of the Bank are immediately, upon employment, eligible to participate in the Bank's 401(k) Plan which is a tax-deferred savings plan designed to assist employees in preparing for their retirement years. Employees may contribute to the Plan up to certain limits prescribed by the Internal Revenue Service. The Bank made $22,225, $18,117 and $17,824 matching employee 401(k) contributions in 2013, 2012, and 2011, respectively.

Note 10. Related Party Transactions

In the ordinary course of business, Bank policies allow the making of loans to directors, officers, principal shareholders and their associates on substantially the same terms, including interest rates, origination and commitment fees, and collateral, as comparable transactions with unaffiliated persons, and such loans do not involve more than the normal risk of collectability. The Bank had no loans and/or extensions of credit made to or guaranteed by the Bank's directors and officers and their related companies at December 31, 2013, and December 31, 2012.

Note 11. Restrictions, Commitments, Contingencies and Other Disclosures

Restrictions on Cash and Due from Banks. As compensation for check clearing and other services, compensating balances of approximately $2,000,000 was maintained with correspondent banks at both December 31, 2013 and December 31, 2012.

Building Lease Commitments. The original operating lease for the Bank's 111 Mission Street office in Santa Cruz, which had an expiration date of November 30, 2012 and an option to extend for three additional 5 year periods, was renegotiated January 13, 2012, effective January 1, 2012. The new monthly lease payment for the Santa Cruz Office is $12,600. This payment includes all building expenses for taxes, insurance and maintenance and the lease payment is fixed at this amount during the initial term through December 31, 2017, inclusive. Additionally, the new lease has an option to extend for two additional five-year periods.

Minimum rental payments for future years under this new lease are as follows:

2014	151,200
2015	151,200
2016	151,200
2017	151,200
	$604,800

Building rent expense was $151,200 for both the years ended December 31, 2013 and 2012 and was $140,400 for the year ended December 31, 2011.

Loan Commitments. The Bank is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets. The contract amounts of those instruments reflect the extent of involvement the Bank has in particular classes of financial instruments.

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on Management's credit evaluation. Collateral held varies but may include cash, securities, accounts receivable, inventory, property, plant and equipment, residential real estate and income-producing commercial properties.

Financial instruments whose contract amounts represent credit risk at December 31, 2013 and December 31, 2012 are as follows:

	December 31,	
	2013	2012
Commitments to extend credit	$33,424,921	$23,733,806
Total unfunded financial commitments	$33,424,921	$23,733,806

Legal Matters. At December 31, 2013, the Bank was not subject to or knows of any claims and/or lawsuits that could have a material financial impact on the operations of the Bank.

Note 12. Fair Value of Financial Instruments

In accordance with applicable accounting guidance, the Bank groups its financial assets and financial 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. These levels are:

- **Level 1**: Valuations for assets and liabilities traded in active exchange markets, such as the New York Stock Exchange. Level 1 also includes U.S. Treasury, other U.S. government and agency mortgage-backed securities that are traded by dealers or brokers in active markets. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

- **Level 2**: Valuations for assets and liabilities traded in less active dealer or broker markets. Valuations are obtained from third party pricing services for identical or comparable assets or liabilities.
- **Level 3**: Valuations for assets and liabilities that are derived from other valuation methodologies, including option pricing models, discounted cash flow models and similar techniques, and not based on market exchange, dealer, or broker traded transactions. Level 3 valuations incorporate certain assumptions and projections in determining the fair value assigned to such assets or liabilities.

The only assets or liabilities measured at fair value on a recurring basis on the Bank's balance sheet at December 31, 2013 and 2012 are the investment securities classified as available for sale totaling $6,414,050 and $14,893,712, respectively. Fair value for this group is based on the Level 2 assumption. Assets measured at fair value on a non-recurring basis at December 31, 2013, and December 31, 2012, consist solely of other real estate owned of $348,750 and $370,000 having a fair value assertion based on the Level 3 assumption.

As of December 31, 2013, 2012 and 2011, specific allocated reserves on OREO properties as well as write-downs on such properties aggregated $21,250, $26,000 and $80,680.

There were no changes in Level 3 assets and liabilities measured at fair value on a recurring basis for the year ended December 31, 2013.

The significant unobservable input is management's adjustments from the appraised value of the property to reflect current conditions and selling costs averaging approximately 7%.

The following table presents the carrying amounts and estimated fair values of the Bank's financial instruments at December 31, 2013 and December 31, 2012. The fair value of financial instruments does not represent actual amounts that may be realized upon any sale or liquidation of the related assets or liabilities. In addition, these values do not give effect to discounts to fair value which may occur when financial instruments are sold in larger quantities. The fair values presented represent the Bank's best estimate of fair value using the methodologies discussed below.

The respective carrying values of certain on-balance-sheet financial instruments approximated their fair values. These financial instruments include cash and cash equivalents, interest-bearing deposits in other banks, banker's bank and Federal Home Loan Bank stock and demand and savings deposits. Carrying values were assumed to approximate fair values for these financial instruments as they are short term in nature and their recorded amounts approximate fair values or are receivable or payable on demand. The Bank does not use derivative financial instruments.

	December 31, 2013		December 31, 2012	
	Amount	Fair Value	Amount	Fair Value
Financial Assets:				
Cash and cash equivalents	$ 4,579,474	$ 4,579,474	$ 34,574,059	$ 34,574,059
Interest-bearing deposits in other banks	31,430,826	131,430,826	17,006,673	17,006,673
Securities available-for-sale	6,414,050	6,414,050	14,893,712	14,893,712
Securities held-to-maturity	7,760,636	7,383,136	–	–
Bankers' bank and Federal Home Loan Bank stock	825,752	825,752	730,452	730,452
Bank Owned Life Insurance	4,269,543	4,269,543	4,123,688	4,123,688
Loans, net	100,077,054	98,808,805	94,845,494	89,972,655
Accrued interest receivable	358,052	358,052	345,290	345,290
Financial Liabilities:				
Noninterest-bearing demand deposits	$ 30,290,175	$ 30,290,175	$ 37,314,565	$ 37,314,565
Interest-bearing demand deposits	8,493,178	8,493,178	7,900,787	7,900,787
Money market deposits	61,255,740	61,255,740	65,489,949	65,489,949
Time certificates of deposit	28,995,592	28,994,642	31,403,040	31,401,956
Savings account deposits	5,460,013	5,460,013	5,015,643	5,015,643
Borrowings	–	–	–	–
Accrued interest payable	9,578	9,578	12,320	12,320

The following methods and assumptions were used to estimate the fair value of other classes of financial instruments:

Securities: The fair values of securities classified as available-for-sale and held-to-maturity are based on quoted market prices at the reporting date for those or similar investments.

Loans: The fair value of fixed rate loans is determined as the present value of expected future cash flows discounted at the interest rate currently offered by the Bank, which approximates rates currently offered by local lending institutions for loans of similar terms to companies with comparable credit risk. Variable rate loans which re-price frequently with changes in approximate market rates were valued using the outstanding principal balance. The estimated fair value of loan commitments and contingent liabilities at December 31, 2013 and December 31, 2012 approximate current book values.

Deposits: The fair values of demand deposits, savings deposits, and money market deposits without defined maturities were the amounts payable on demand. For substantially all deposits with defined maturities, the fair values were calculated using discounted cash flow models based on market interest rates for different product types and maturity dates. For variable rate deposits where the Bank has the contractual right to change rates, carrying value was assumed to approximate fair value. The discount rates used were based on rates for comparable deposits.

Note 13. Other Operating Income and Expense

The following is a breakdown of other non-interest income and non-interest expense in the Statement of Operations:

	2013	2012	2011
Other non-interest income:			
Gain (loss) on sale of assets	$ 250	$ (1,599)	$ 89,644
Wire transfer fees	8,200	7,340	7,000
Merchant card processing	13,283	5,025	4,353
Imprinted check sales	4,533	4,027	3,700
Internet banking fees	6,310	5,620	5,205
Safe deposit fees	3,150	3,160	2,800
BOLI non-interest income	145,854	123,688	–
Other non-interest income	43,023	59,469	33,447
Total other non-interest income	$ 224,603	$ 206,730	$ 146,149
Other operating expense:			
Other real estate owned expense	$ 27,250	$ 36,406	$ 124,239
Regulatory assessments	91,171	180,580	181,606
Correspondent bank charges	56,248	59,443	52,111
Stationery, supplies and printing	31,360	25,559	23,136
Shareholder related expense	18,799	30,729	30,787
Insurance and security	26,394	26,384	26,360
Telephone, postage and electronic communications	21,237	22,154	23,241
Director fees	78,425	67,650	57,234
Loan and collection expense	15,005	21,965	16,053
Armored car and messenger	8,718	8,115	7,953
ATM surcharge fees	9,280	8,817	7,392
Publications and subscriptions	12,050	15,009	12,602
Meetings, conferences, education, and training	9,600	8,800	5,713
Human resources administration fees	2,536	2,264	2,278
Dues and memberships	10,418	6,331	4,951
Customer checks and stamps	5,125	5,028	5,859
Other operating expenses	70,570	95,813	33,179
Total other operating expenses	$ 494,186	$ 621,047	$ 614,694

Note 14. Capital Adequacy

The Bank is subject to various regulatory capital adequacy requirements administered by the banking regulatory agencies. The Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) required that the federal regulatory agencies adopt regulations defining five capital tiers for depository institutions: well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, would have a direct material effect on the Bank's financial statements.

Quantitative measures, established by the regulators to ensure capital adequacy, require that the Bank maintain minimum ratios (set forth in the following table) of capital to risk-weighted assets and average assets. Management believes that, as of December 31, 2013, the Bank met all capital adequacy requirements to which they were subject.

The most recent notification from the FDIC categorized the Bank as well capitalized under the FDICIA regulatory framework for prompt corrective action. To be categorized as well capitalized; the institution must maintain a total risk-based capital ratio as set forth in the following table and not be subject to a capital directive order (such as a Formal Agreement). There are no conditions or events since that notification that Management believes has changed the Bank's risk-based category.

(Dollars in thousands)	Actual		For Capital Adequacy Purposes:		For Regulatory Adequacy Purposes (first seven years)		To Be Well Capitalized Under the FDICIA Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2013								
Total capital (to risk-weighted assets)	$24,545	18.45%	$10,640	8.00%	$ 13,300	10.00%	$13,300	10.00%
Tier 1 capital (to risk-weighted assets)	$22,866	17.19%	$ 5,320	4.00%	$ 7,980	6.00%	$ 7,980	6.00%
Tier 1 capital (to average assets) leverage ratio	$22,866	14.34%	$ 6,379	4.00%	$ 12,757	8.00%	$ 7,973	5.00%
As of December 31, 2012								
Total capital (to risk-weighted assets)	$22,015	18.18%	$ 9,686	8.00%	$ 12,108	10.00%	$12,108	10.00%
Tier 1 capital (to risk-weighted assets)	$20,484	16.92%	$ 4,843	4.00%	$ 7,265	6.00%	$ 7,265	6.00%
Tier 1 capital (to average assets) leverage ratio	$20,484	12.07%	$ 6,791	4.00%	$ 13,582	8.00%	$ 8,489	5.00%

The leverage ratio consists of Tier 1 capital divided by quarterly average assets, excluding intangible assets and certain other items. The minimum leverage ratio guideline is 4% for banking organizations that do not anticipate significant growth and that have well-diversified risk, excellent asset quality, high liquidity, good earnings and, in general, are considered top-rated, strong banking organizations. Throughout its first seven years of operation, the Bank is required to maintain a Tier 1 Leverage Ratio of not less than 8%

Note 15. Regulatory Matters

Under the terms of approval of deposit insurance by the Federal Deposit Insurance Corporation, the Bank's Tier 1 capital-to-assets leverage ratio (as defined in the appropriate capital regulation and guidance from the Bank's primary federal regulator) shall be maintained at not less than 8% throughout its initial seven years of operation. Additionally, the FDIC's approval requires that the Bank now operate within the parameters of its extended de novo business plan, during years four through seven, and that any major deviation or material changes from the plans be submitted 60 days before consummating the change.

Board of Directors

(In order from left to right)

James L. Weisenstein
President
Graystone Consulting, LLC.
Chief Executive Officer
DayOne Solar, Inc.

Richard G. Hofstetter
President and Chief Executive Officer
Lighthouse Bank

Stephen D. Pahl
Senior Partner and Chairman
Pahl & McCay
a Professional Law Corporation

John C. Burroughs, Chairman
Certified Financial Planner
Founder and Owner
Burroughs Financial Services
Chairman
Foothill Securities, Inc.

Bruce A. McPherson
Fifth District Supervisor
Santa Cruz County

William R. Slakey
Executive Vice President and
Chief Financial Officer
Echelon Corporation

Michael P. Dunn, D.O.
Physician
Watsonville Emergency Medical Group
Santa Cruz Emergency Physicians

Craig A. French
President
French Resources Group, Inc.

Supporting our Community

Following is a list of some of the local organizations which the Bank, our Directors and Employees have generously supported:

- American Cancer Society
- American Red Cross
- Aptos Sports Foundation
- Big Brothers Big Sisters
- Big Stick Surfing Association
- Boomerang Foundation
- Boys & Girls Club of Santa Cruz
- Cabrillo College Foundation
- California Grey Bears
- California State Parks Foundation
- Clean Oceans Project
- Community Bridges
- Cultural Council of Santa Cruz County
- Cystic Fibrosis Foundation
- Dientes
- Dominican Hospital Foundation
- Family Service Agency of the Central Coast
- Habitat for Humanity
- Happy Valley Elementary School
- Harbor High School
- Hope Services

Senior Management

(In order from left to right)

Donald H. Soman
Executive Vice President
Chief Financial Officer

Kimberly M. Raynal
Executive Vice President
Chief Operating Officer

Richard G. Hofstetter
President
Chief Executive Officer

Kristin Ditlevsen
Senior Vice President
Lending Group Manager

Lane S. Lawson, Jr.
Executive Vice President
Chief Credit Officer

Supporting our Community *(continued)*

- Human Care Alliance
- Imagine Supported Living Services
- Jacob's Heart
- Kids on Broadway
- Long Marine Lab
- Monte Foundation
- Mount Madonna School
- Muscular Dystrophy Association
- MAH @ the McPherson Center
- National Marine Sanctuary Foundation
- Omega Nu
- Opening Doors to Community
- Organic Farming Research
- Pacific Collegiate School
- Salvation Army Santa Cruz Corps
- Sanctuary Exploration Center
- Santa Cruz Art League
- Santa Cruz City Youth Soccer Club
- Santa Cruz Community Counseling Center
- Santa Cruz County Bar Association
- Santa Cruz County Soccer Fund

Staff

(In order from left to right)

Lisa Ratliff
Loan Operations Officer

Ruby Stiga
Loan Servicing Specialist

Matthew Sclafani
Assistant Vice President
Controller

Kat Baumert
Client Service Representative

Joey Garcia
Service Manager

Renee Cerruti
Loan Support Specialist

Matthew Sinnott
Deposit Services Officer

Michelle Cole
Vice President
Loan Operations Manager

Dara Harris
Assistant Vice President
Relationship Manager

Richard Harker
Assistant Vice President
Relationship Manager

Judy Spellerberg
Senior Client Service Representative

Brianna Carabba
Vice President
Executive Administrator

Claudia Morales
Client Service Representative

(Not pictured)

Jamie Ganly
Vice President
Senior Construction and
Commerical Real Estate
Relationship Manager

Supporting our Community *(continued)*

- Santa Cruz County Symphony
- Santa Cruz County Trial Lawyers Association
- Santa Cruz Education Foundation
- Santa Cruz Gals Softball
- Santa Cruz G-Ball
- Santa Cruz High Baseball
- Santa Cruz Little League
- Santa Cruz Sunrise Rotary Save our Shores
- Scotts Valley Educational Foundation
- Scotts Valley Little League
- Second Harvest Food Bank
- Senior Citizens Legal Services
- Tannery Arts Center
- United Way of Santa Cruz County
- Vine Hill Elementary School
- Vista Center for the Blind & Visually Impaired
- Volunteer Centers of Santa Cruz County
- Walnut Avenue Women's Center
- Your Future is Our Business

Advisory Board

Christen Allaman, M.D.
President and Medical Director
Eye Care Medical Group, Inc.

President and Medical Director
Cypress Outpatient Surgical Center

Frank "Buzz" Anderson
Businessman

James Baker
Superintendent Retired
Pajaro Valley Unified School District

Kenneth Bergman
President
Scotts Valley Realty

Blaine Brokaw
Broker
ANB Insurance Services

Linda Burroughs
Co-Chair

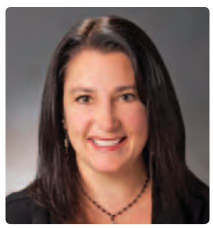
Owner/Broker
Linda Burroughs Real Estate

Bruce Dunn, M.D.
Retired Physician

Peter Gaarn
Co-Chair

Peter Gaarn & Associates

Russell E. Gross
President/Broker
Russell E. Gross Real Estate, Inc.



Brigid Heath
Branch Manager/ Escrow Officer
Old Republic Title Company

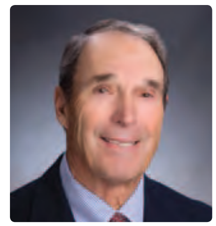
Alan Heit, D.D.S.
Alan Heit Family Dentistry

Sandra Hill
Sandra Hill Fiduciary Services

David Jacobs, C.P.A.
Chiorini, Hunt & Jacobs

Larry Kerr, D.V.M., D.A.C.V.R.
President
Veterinary Radiology Specialists

Gary Marietti, D.D.S.
Retired

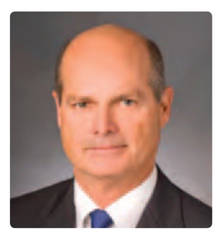


Hon. John A. Marlo
Retired

Mediator and Arbitrator
JAMS

Bill McDermott, C.P.A.
Fournier, McDermott & Lamb

Jesse L. Nickell III
Senior Vice President Construction and Development
Barry Swenson Builder



Matt Shelton
Owner/Broker
J.R. Parrish Commercial Real Estate

Shareholder Relations and Information

Stock Information

Lighthouse Bank's stock is listed and publicly traded on the Over-the-Counter Bulletin Board (OTCBB) and trades under the ticker symbol LGHT.

Market Maker

Raymond James & Associates
John T. Cavender
(415) 616-8935
John.Cavender@RaymondJames.com

Shareholders with questions regarding their stockholder account, stock transfer, lost certificates or changes of address should contact their broker. In the event that certificates are held directly, shareholders should contact the Bank's stock transfer agent:

Registrar & Transfer Company
Attn: Investor Relations
10 Commerce Drive
Cranford, NJ 07016
Phone: (800) 368-5948

For assistance with other stock related matters or to change your contact information for periodic shareholder communications sent directly from the Bank, shareholders should contact:

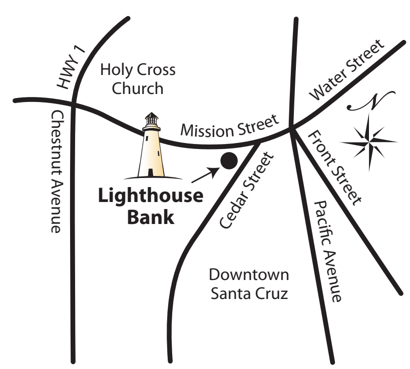
Brianna Carabba
Vice President
Executive Administrator
Lighthouse Bank
111 Mission Street
Santa Cruz, CA 95060
Phone: (831) 600-4007

For financial information beyond that shown in this report, shareholders should contact:

Donald H. Soman
Executive Vice President
Chief Financial Officer
Lighthouse Bank
111 Mission Street
Santa Cruz, CA 95060
Phone: (831) 600-4009

LIGHTHOUSE BANK

111 Mission Street
Santa Cruz, CA 95060
(831) 600-4000
www.lighthousebank.net



EQUAL HOUSING LENDER
Member FDIC

LIGHTHOUSE BANK

ORGANIZERS

- Douglas & Jo-Ann Austin
- Don & Barbara Bargiacchi
- Gary & Valerie Benito
- Ken & Debra Bergman
- Chip & Suzie Bogaard
- Blaine & Connie Brokaw
- William Brooks
- John & Linda Burroughs
- Marshall & Sabrina Delk
- Dr. Michael & Julie Dunn
- Craig & Mimi French
- Peter & Nancy Port-Gaarn
- Doak & Jeri Gintert
- Russell & Alana Gross
- Richard G. Hofstetter
- Larry Kerr & Jennifer Antrim
- Gary & Lynn Marietti
- Lido & Marie Marietti
- Bill & Julie McDermott
- Bruce & Mary McPherson
- Dr. Ritu & Robert Meister
- Herman Mondo
- Richard Murphy
- Jesse & Christine Nickell
- Tom & Lisa O'Rourke
- Stephen & Louise Pahl
- Rowland & Pat Rebele
- Hans Schroeder
- Jon & Margie Sisk
- William & Peggy Slakey
- James & Carol Weisenstein
- Whiting's Foods
- Peter & Jackie Whiting
- Tim & Ann Williams
- Andy Zehnder

LIGHTHOUSE
BANK

111 Mission Street, Santa Cruz, CA 95060 ▪ Phone: (831) 600-4000 ▪ Fax: (831) 427-2260 ▪ www.lighthousebank.net