2011
Annual Report

Lighthouse Bank

Lighthouse Bank

Supporting our Community

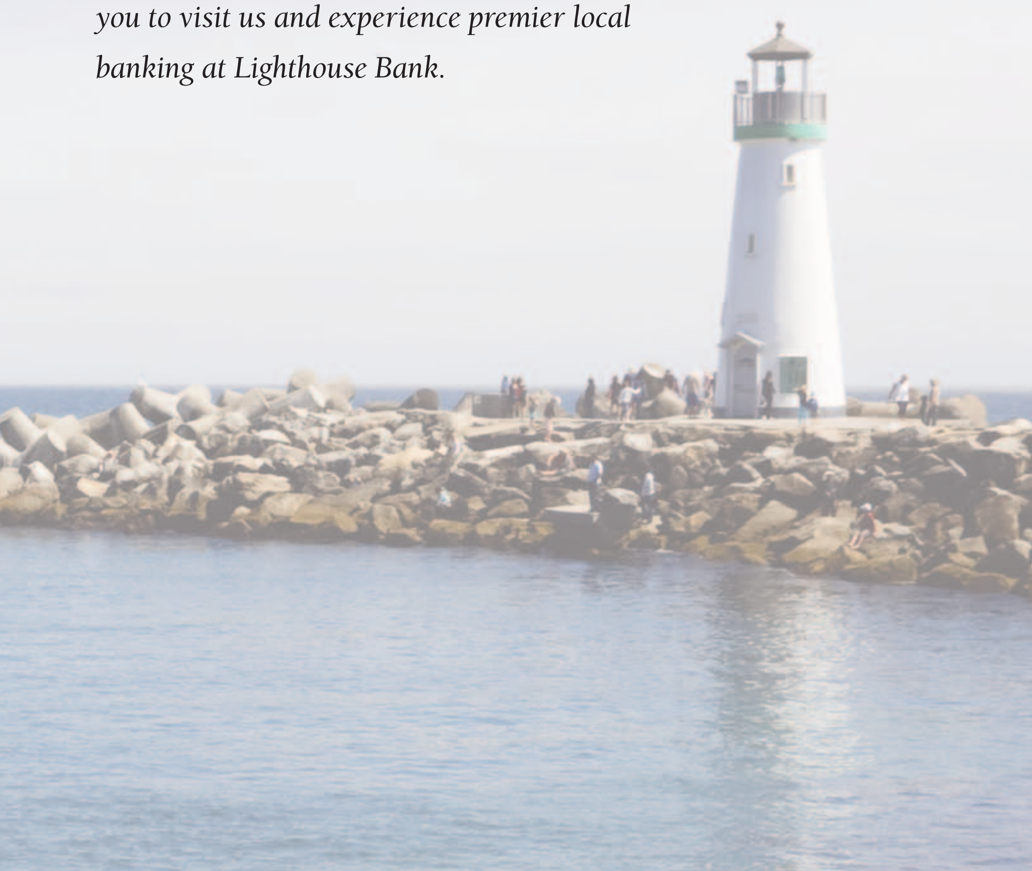
Following is a list of some of the local organizations which the Bank, our Directors and Employees have generously supported:

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 State Parks Foundation
Clean Oceans Project
Community Bridges
Cultural Council of Santa Cruz County
Dominican Hospital Foundation
Family Service Agency of the Central Coast
Habitat for Humanity
Happy Valley Elementary School
Harbor High School
Human Care Alliance
Jacob's Heart
Kids on Broadway
Long Marine Lab
Mount Madonna School
Muscular Dystrophy Association
MAH @ the McPherson Center
National Marine Sanctuary Foundation
Omega Nu
Organic Farming Research
Pacific Collegiate School
Salvation Army Santa Cruz Corps
Sanctuary Exploration Center
Santa Cruz City Youth Soccer Club
Santa Cruz County Bar Association
Santa Cruz County Soccer Fund
Santa Cruz County Symphony
Santa Cruz County Trial Lawyers Association
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

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.



A Letter To Our Owners

To our Owners, Employees, Clients and Community,

John C. Burroughs
Chairman of the Board

Richard G. Hofstetter
President and CEO

ON BEHALF of the Board of Directors and Management of Lighthouse Bank, we present our financial results for the fiscal year ended December 31, 2011. We are pleased to report that the Bank continued to experience solid growth throughout the year with actual performance exceeding our projections in a number of key areas.

While the nation began showing signs of a modest economic recovery in 2011, the growth of Lighthouse Bank dramatically outpaced that of the economy at large. The Bank's increasing name recognition combined with national and local trends in support of community banking fueled our consistent loan and deposit growth during the year. As a result, Lighthouse Bank achieved a number of significant milestones during 2011 which contributed to our success and bode well for our ability to continue to deliver top quality service to our clients and strong returns to our owners. The following achievements were particularly noteworthy:

- Deposits exceeded $100 million for the first time
- Annual Income exceeded $1 million for the first time
- A 10% stock dividend was issued on December 5, 2011
- No staff turnover during 2011
- Loan loss reserves were increased to a conservative 3.3% of total loans
- Fourth consecutive year with zero charge-offs (loan losses)
- Non-performing assets decreased to a four-year low of $396 thousand
- Earning assets, as a percentage of total assets, increased to a record high 98.9%
- The Bank achieved a Bauer Financial 4-Star "Excellent" rating based on December 31, 2011 results.

As we move into 2012, management and the board remain committed to growing the company and providing tangible benefit for our owners. Our business model of combining highly personalized service and operational efficiency has served us well and is rapidly becoming the industry standard. We have high expectations for our performance this year and are confident in our ability to provide ongoing value to our owners, clients and community regardless of the economic environment.

As always, we would like to thank our owners, clients and staff for their continued support as we move forward to meet the challenges and uncover the opportunities that lie ahead. Please join us at our annual shareholder meeting at the Museum of Art and History at the McPherson Center on Thursday, May 17, 2012 at 4:00 P.M.

Sincerely,

John C. Burroughs
Chairman of the Board

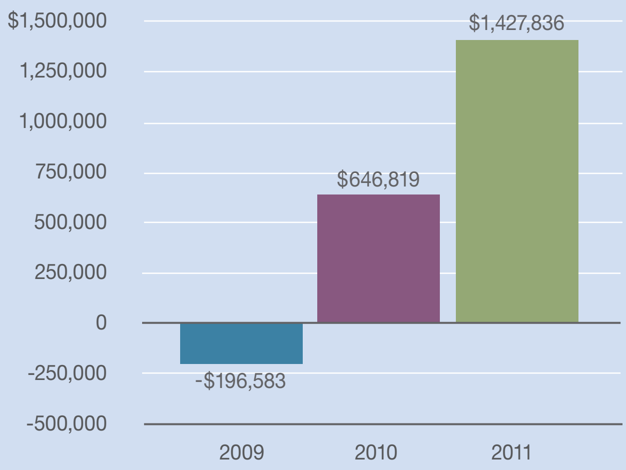
Richard G. Hofstetter
President and CEO

Our Mission Statement

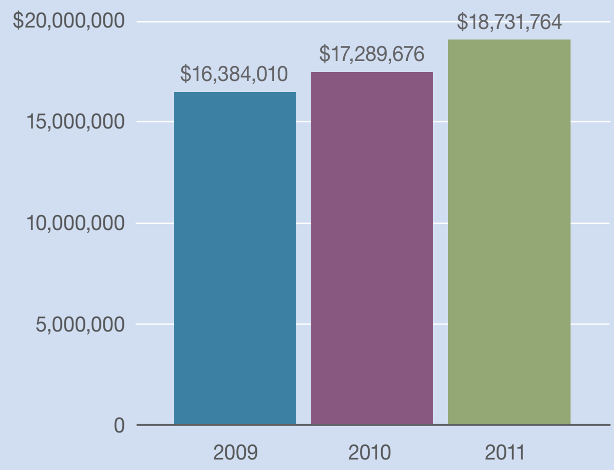
Lighthouse Bank is committed to providing superior personalized banking products and services in Santa Cruz County. We are dedicated to creating financial benefit for our clients, professional growth for our employees and financial prosperity for our owners and community.

Financial Summary

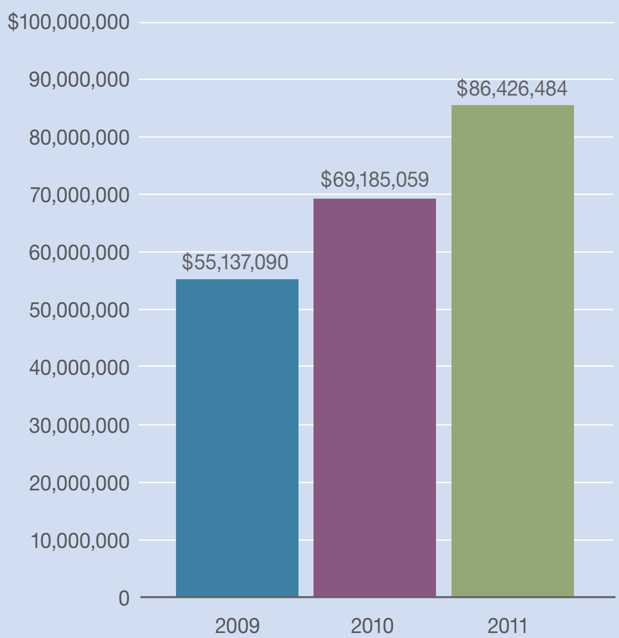
Net Income After Tax



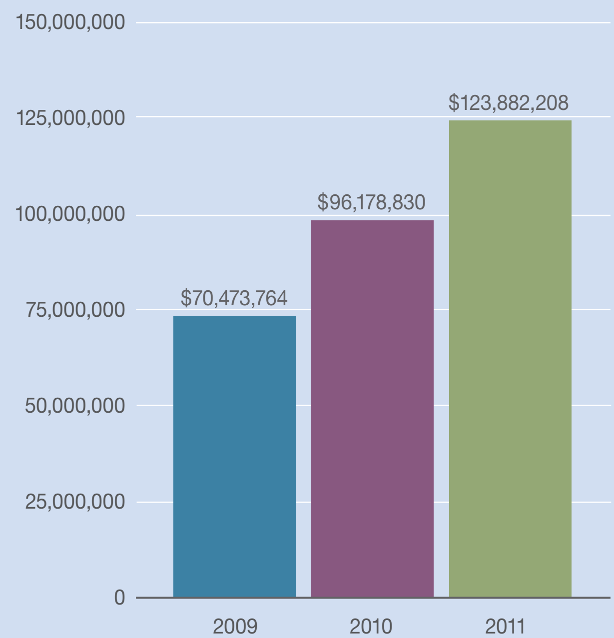
Total Shareholders' Equity



Total Gross Loans



Total Deposits



VAVRINEK, TRINE, DAY
& COMPANY, LLP
Certified Public Accountants
www.vtdcpa.com

VALUE THE DIFFERENCE

INDEPENDENT AUDITOR'S REPORT

The Board of Directors
Lighthouse Bank

We have audited the balance sheets of Lighthouse Bank as of December 31, 2011, and 2010 and the related statements of operations, changes in stockholders' equity and other comprehensive income, and cash flows for each of the years in the three year period ended December 31, 2011. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Lighthouse Bank as of December 31, 2011 and 2010 and the results of its operations and its cash flows for each of the years in the three year period ended December 31, 2011, in conformity with accounting principles generally accepted in the United States of America.

Vavrinek Trine Day + Co. LLP

Palo Alto, California
March 8, 2012

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,	
	2011	2010
Assets		
Cash and due from banks	$ 21,254,988	$ 17,455,690
Federal funds sold	50,000	576,000
Total cash and cash equivalents	21,304,988	18,031,690
Interest-bearing deposits in other financial institutions	28,280,805	24,698,574
Investment securities:		
Securities available-for-sale, at estimated fair value	7,106,750	2,719,871
Loans receivable:		
Gross loans	86,426,484	69,185,059
less deferred loan fees, net of costs	(478,533)	(405,218)
less reserve for loan losses	(2,855,000)	(1,925,000)
Net loans	83,092,951	66,854,841
Premises and equipment, net	122,844	257,076
Accrued interest receivable	329,595	320,781
Federal Home Loan Bank and bankers' bank stock, at cost	594,597	581,373
Other real estate owned	396,000	2,548,244
Other assets	1,915,783	817,179
Total Assets	$ 143,144,313	$ 116,829,629
Liabilities and Shareholders' Equity		
Liabilities:		
Deposits:		
Noninterest-bearing demand deposits	$ 31,366,553	$ 20,258,708
Interest-bearing demand deposits	10,133,478	7,523,211
Savings and money market deposits	53,727,633	46,168,868
Time deposits	28,654,544	22,228,043
Total deposits	123,882,208	96,178,830
Other liabilities:		
Accrued interest payable	11,940	11,950
Borrowings	–	3,000,000
Other liabilities	518,401	349,173
Total liabilities	124,412,549	99,539,953
Shareholders' Equity:		
Common stock, no par value, 10,000,000 shares authorized: issued and outstanding; 2,038,324 shares at December 31, 2011 and 1,853,028 shares at December 31, 2010	20,178,232	18,484,627
Additional paid-in-capital	1,108,323	1,098,165
Accumulated (deficit)	(2,663,128)	(2,397,297)
Accumulated other comprehensive income	108,337	104,181
Total shareholders' equity	18,731,764	17,289,676
Total Liabilities and Shareholders' Equity	$ 143,144,313	$ 116,829,629

See accompanying notes to the Financial Statements

Statements of Operations

	Year Ended December 31,		
	2011	2010	2009
Interest Income:			
Interest and fees on loans	$5,846,845	$4,746,339	$ 3,785,073
Investment securities	323,924	452,692	525,172
Federal funds sold and other interest income	43,064	28,845	14,278
Total interest income	6,213,833	5,227,876	4,324,523
Interest Expense:			
Deposits and other borrowed funds	641,952	699,979	768,035
Net interest income before provision for loan losses	5,571,881	4,527,897	3,556,488
Provision for loan losses	930,000	541,000	413,000
Net interest income after provision for loan losses	4,641,881	3,986,897	3,143,488
Non-Interest Income:			
Service charges on deposit accounts	120,605	256,384	102,555
Other non-interest income	146,149	83,552	32,749
Total non-interest income	266,754	339,936	135,304
Non-Interest Expense:			
Salaries and employee benefits	2,126,370	2,168,383	2,141,394
Occupancy	259,000	259,686	257,463
Furniture and equipment	190,983	223,455	229,033
Marketing and business development	52,868	58,468	52,475
Item and data processing	159,656	160,431	156,107
Professional services	166,461	123,499	90,679
Other operating expenses	614,694	730,828	547,424
Total non-interest expense	3,570,032	3,724,750	3,474,575
Income (loss) before income taxes	1,338,603	602,083	(195,783)
Income tax expense (benefit)	(89,233)	(44,736)	800
Net income (loss)	$ 1,427,836	$ 646,819	$ (196,583)
Earnings (loss) per share:			
Basic	$ 0.70	$ 0.32	$ (0.10)
Diluted	$ 0.70	$ 0.32	$ (0.10)

See accompanying notes to the Financial Statements

Statement of Shareholders' Equity

For the three years ended December 31, 2011

	Common Shares	Amount	Additional Paid-In Capital	Accumulated Deficit	Other Comprehensive Income	Total Shareholders' Equity
Balance at January 1, 2009	1,853,028	$18,484,627	$ 487,856	$ (2,847,533)	$ 50,578	$ 16,175,528
Stock-based compensation	–	–	355,257	–	–	355,257
Net loss	–	–	–	(196,583)	–	(196,583)
Unrealized gain on securities available-for-sale, net of tax of $0	–	–	–	–	49,808	49,808
Balance at December 31, 2009	1,853,028	18,484,627	843,113	(3,044,116)	100,386	16,384,010
Stock-based compensation	–	–	255,052	–	–	255,052
Net income	–	–	–	646,819	–	646,819
Unrealized gain on securities available-for-sale, net of tax of $0	–	–	–	–	3,795	3,795
Balance at December 31, 2010	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, net of tax of $0	–	–	–	–	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

See accompanying notes to the Financial Statements

Statements of Cash Flows

	Year Ended December 31,		
	2011	2010	2009
Operating Activities:			
Net income (loss)	$ 1,427,836	$ 646,819	$ (196,583)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization of premises and equipment	138,632	179,820	185,995
Provision for loan losses	930,000	541,000	413,000
Deferred income tax benefit	(1,199,000)	(477,942)	–
Net amortization/accretion of investment discounts and premiums	4,353	5,697	12,219
Increase in deferred loan fees, net of costs	73,315	130,349	23,543
Stock-based compensation	10,158	255,052	355,257
Loss on disposal of equipment	1,744	255	–
Gain on sale of OREO	(89,644)	(51,412)	–
Writedown on foreclosed assets	80,680	87,603	–
Net (increase) decrease in:			
Accrued interest receivable	(8,814)	(91,517)	(40,237)
Other assets	100,396	95,169	(391,958)
Net increase (decrease) in:			
Accrued interest payable	(10)	(4,476)	(7,079)
Other liabilities	169,228	168,755	69,521
Net cash provided by operating activities	1,638,874	1,485,172	423,678
Investing Activities:			
Available-for-sale securities:			
Principal repayments	728,600	1,043,589	950,050
Purchases	(5,115,676)	(1,005,938)	–
Purchase of Federal Home Loan Bank stock	(11,400)	(115,400)	(184,000)
Purchase of bankers' bank stock	(1,825)	(1,698)	(1,574)
Net (increase) in time deposits with other banks	(3,581,000)	(7,971,000)	(4,277,000)
Net (increase) in other interest-bearing deposits with other banks	(1,231)	(245,574)	–
Net (increase) in loans	(17,241,425)	(14,047,969)	(16,779,542)
Purchase of premises and equipment	(6,205)	(3,672)	(25,501)
Proceeds from sale of OREO	2,161,208	1,385,555	–
Net cash used in investing activities	(23,068,954)	(20,962,107)	(20,317,567)
Financing Activities:			
Increase in:			
Demand deposits	13,718,112	12,440,817	2,551,847
Savings and money market deposits	7,558,765	13,446,007	10,454,830
Time deposits	6,426,501	(181,758)	8,821,365
Other borrowings	(3,000,000)	(1,100,000)	4,100,000
Net cash provided by financing activities	24,703,378	24,605,066	25,928,042
Net increase in cash and cash equivalents	3,273,298	5,128,131	6,034,153
Cash and cash equivalents at beginning of period	18,031,690	12,903,559	6,869,406
Cash and cash equivalents at end of period	$21,304,988	$18,031,690	$ 12,903,559
Supplemental Disclosures of Cash Flow Information			
Total interest paid	$ 641,962	$ 704,455	$ 775,114
Total income taxes paid	986,000	380,800	800
Transfer of loans to other real estate owned	–	706,024	3,882,387

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 Financial Institutions 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 117 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, 2011, the Bank had loans outstanding of approximately $75,888,000 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 8, 2012, which is the date the financial statements were available to be issued.

Summary of Significant Accounting Policies — The accounting and reporting policies of the Bank conform to generally accepted accounting principles in the United States of America and prevailing practices within the banking industry. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported accounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The following is a summary of significant policies used in the preparation of the accompanying financial statements.

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 $563,000 and $24,000 at December 31, 2011, and December 31, 2010, 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 and Agency mortgage-backed 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, 2011, there were no transfers between classifications. 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 established through periodic provisions for possible loan losses. Loans are charged against the allowance for loan losses when Management believes that the collectability of the principal is unlikely. The allowance is a reserve to provide for possible losses on existing loans that may become uncollectable, based on evaluations of the collectability of loans and prior loan loss experience. The evaluations include consideration of changes in the nature and volume of the loan portfolio, overall portfolio quality, a review of specific problem loans, and current economic conditions that may affect the borrowers' ability to pay. 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. Factors considered in determining impairment include payment status, collateral value and the probability of collecting all amounts when due.

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. Due to the operating losses incurred during 2009 there were no potentially dilutive securities at December 31, 2009. The weighted average shares outstanding were 2,038,324 for the years ended December 31, 2011, 2010 and 2009. In addition, in 2011 and 2010 there were no potentially dilutive securities outstanding.

Comprehensive Income — Changes in unrealized gains and losses on available-for-sale securities is the only component of accumulated other comprehensive income for the Bank. The Bank had accumulated other comprehensive income totaling $4,156, $3,795 and $49,808 at December 31, 2011, December 31, 2010 and December 31, 2009, respectively.

	2011	2010	2009
Net Income (loss)	$ 1,427,836	$ 646,819	$ (196,583)
Unrealized gain on securities available for sale	4,156	3,795	49,808
Total comprehensive income (loss)	$ 1,431,992	$ 650,614	$ (146,775)

Adoption of New Accounting Standards

In July 2010, the Financial Accounting Standard Board ("FASB") amended guidance to require significantly more information about the credit quality of the Bank's loan portfolio. Although this statement addresses only disclosure and does not seek to change recognition or measurement, the disclosure represents a meaningful change in practice. The new disclosures are effective for annual reporting periods ending after December 15, 2011 and are included in these financial statements.

In April 2011, the FASB amended existing guidance for assisting a creditor in determining whether a restructuring is a troubled debt restructuring ("TDR"). The amendments clarify the guidance for a creditor's evaluation of whether it has granted a concession and whether a debtor is experiencing financial difficulties. This guidance will be effective for annual reporting periods ending after December 15, 2012, and applied retrospectively to the beginning of the annual period of adoption. The new guidance is not expected to have a significant impact on the Bank's determination of whether a restructuring is a TDR.

Newly Issued But Not Yet Effective Standards

In May, 2011, the FASB issued an amendment to achieve common fair value measurement and disclosure requirements between U.S. and International accounting principles. Overall, the guidance is consistent with existing U.S. accounting principles; however, there are some amendments that change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. The amendment in this guidance will be effective for annual reporting periods beginning after December 15, 2011. The amendment is not expected to significantly impact the Bank.

In September 2011, the FASB amended existing guidance and eliminated the option to present the components of other comprehensive income as part of the statement of changes in shareholders' equity. The amendment requires that comprehensive income be presented in either a single continuous statement or in two separate consecutive statements. This amendment will be effective for annual reporting periods beginning after December 15, 2011. The adoption of this amendment will change the presentation of the components of comprehensive income for the Bank as part of the statement of shareholders' equity.

Note 2. Investment Securities

The following table summarizes Lighthouse Bank's securities available-for-sale at December 31, 2011, and December 31, 2010:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
December 31, 2011				
Securities available-for-sale				
U.S. Agency	$ 1,000,000	$ 530	$ –	$ 1,000,530
U.S. Agency MBSs	5,998,413	112,048	(4,241)	6,106,220
Total securities available-for-sale	$ 6,998,413	$ 112,578	$ (4,241)	$ 7,106,750
December 31, 2010				
Securities available-for-sale:				
U.S. Agency MBSs	$ 2,615,690	$ 104,181	$ –	$ 2,719,871
Total securities available-for-sale	$ 2,615,690	$ 104,181	$ –	$ 2,719,871

The amortized cost and estimated fair value of investment securities at December 31, 2011 and December 31, 2010 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, 2011		
Due in one year or less	$ –	$ –
Due after one year through five years	1,000,000	1,000,530
Due after five years through ten years	–	–
Mortgage-backed securities	5,998,413	6,106,220
Total	$ 6,998,413	$ 7,106,750
December 31, 2010		
Due in one year or less	$ –	$ –
Due after one year through five years	–	–
Due after five years through ten years	–	–
Mortgage-backed securities	2,615,690	2,719,871
Total	$ 2,615,690	$ 2,719,871

As of December 31, 2011 and 2010, there are no investment securities that have been in a temporary unrealized loss position for 12 months or longer. No investment securities were sold in 2011 or 2010. There were no investment securities required to be pledged to secure public deposits at December 31, 2011 and December 31, 2010, or for any other purposes, required or permitted by law. Investment securities pledged to secure Federal Home Loan Bank borrowings (note 7) at December 31, 2011 and December 31, 2010, were $0 and $1,000,000, respectively.

Note 3. Loans

Loan maturity and rate sensitivity data of the loan portfolio at December 31, 2011 and 2010 are as follows (in thousands):

December 31, 2011	Within One Year	One to Five Years	After Five Years	Total
Loans secured by real estate, land and construction loans	$ 24,059	$ 22,672	$ 29,157	$ 75,888
Consumer and other loans	104	–	–	104
Commercial and revolving lines	4,987	4,395	1,052	10,434
	$ 29,150	$ 27,067	$ 30,209	$ 86,426
Loans at fixed interest rates	$ 23,542	$ 24,626	$ 26,762	$ 74,930
Loans at variable interest rates	5,608	2,441	3,447	11,496
	$ 29,150	$ 27,067	$ 30,209	$ 86,426

December 31, 2010	Within One Year	One to Five Years	After Five Years	Total
Loans secured by real estate, land and construction loans	$ 19,878	$ 26,844	$ 13,590	$ 60,312
Consumer and other loans	41	6	–	47
Commercial and revolving lines	3,578	4,338	910	8,826
	$ 23,497	$ 31,188	$ 14,500	$ 69,185
Loans at fixed interest rates	$ 20,390	$ 22,364	$ 12,705	$ 55,459
Loans at variable interest rates	3,107	8,824	1,795	13,726
	$ 23,497	$ 31,188	$ 14,500	$ 69,185

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

	2011	2010	2009
Balance at beginning of year	$1,925,000	$1,384,000	$ 971,000
Provision for loan losses	930,000	541,000	413,000
Loan charge-offs	–	–	–
Recoveries of loan charge-offs	–	–	–
Balance at year end	$ 2,855,000	$ 1,925,000	$ 1,384,000

The following table presents the activity in the allowance for loan losses for the year 2011 and the recorded investment in loans and impairment method as of December 31, 2011 and 2010 by portfolio segment:

December 31, 2011	Commercial Real Estate	Residential Real Estate	Commercial	Consumer	Total
Allowance for Loan Losses:					
Beginning of Year	$ 1,541,841	$ 77,990	$ 304,490	$ 679	$ 1,925,000
Provisions	804,482	5,509	120,607	(598)	930,000
Charge-offs	–	–	–	–	–
Recoveries	–	–	–	–	–
End of Year	$ 2,346,323	$ 83,499	$ 425,097	$ 81	$ 2,855,000
Reserves:					
Specific	$ 609,461	$ –	$ 3,480	$ –	$ 612,941
General	1,736,862	83,499	421,617	81	2,242,059
	$ 2,346,323	$ 83,499	$ 425,097	$ 81	$ 2,855,000
Loans Evaluated for Impairment:					
Individually	$ 3,953,440	$ –	$ 69,601	$ –	$ 4,023,041
Collectively	61,391,656	4,167,493	16,839,263	5,031	82,403,443
	$ 65,345,096	$ 4,167,493	$ 16,908,864	$ 5,031	$ 86,426,484

December 31, 2010	Commercial Real Estate	Residential Real Estate	Commercial	Consumer	Total
Reserves:					
Specific	$ 725,150	$ –	$ 2,333	$ –	$ 727,483
General	816,691	77,990	302,157	679	1,197,517
	$ 1,541,841	$ 77,990	$ 304,490	$ 679	$ 1,925,000
Loans Evaluated for Impairment:					
Individually	$ 9,561,826	$ –	$ 46,667	$ –	$ 9,608,493
Collectively	39,454,962	4,673,072	15,393,341	55,191	59,576,566
	$ 49,016,788	$ 4,673,072	$ 15,440,008	$ 55,191	$ 69,185,059

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.

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 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, 2011 and 2010:

December 31, 2011	Pass	Special Mention	Substandard	Impaired	Total
Loans:					
Construction and land	$13,364,069	$ –	$ 1,425,614	$ –	$14,789,683
Commercial real estate	48,027,587	1,771,140	756,686	–	50,555,413
Residential real estate	4,167,493	–	–	–	4,167,493
Commercial and industrial	14,416,423	69,601	–	–	14,486,024
Small Business Administration	2,422,840	–	–	–	2,422,840
Other	5,031	–	–	–	5,031
	$82,403,443	$ 1,840,741	$ 2,182,300	$ –	$86,426,484

December 31, 2010	Pass	Special Mention	Substandard	Impaired	Total
Loans:					
Construction and land	$ 13,057,919	$ –	$ 2,987,788	$ –	$16,045,707
Commercial real estate	26,397,043	5,597,352	976,686	–	32,971,081
Residential real estate	4,673,072	–	–	–	4,673,072
Commercial and industrial	13,908,763	46,667	–	–	13,955,430
Small Business Administration	1,484,578	–	–	–	1,484,578
Other	55,191	–	–	–	55,191
	$59,576,566	$ 5,644,019	$ 3,964,474	$ –	$69,185,059

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, 2011, 2010 and 2009, 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:

	December 31, 2011	2010	2009
Impaired Loans:			
Recorded investment in impaired loans	$ –	$ –	$ 706,024
Related allowance for loan losses	–	–	–
Average recorded investment in impaired loans	–	148,942	2,715,495
Interest income recognized for cash payments while impaired	–	–	–
Total loans on non-accrual	–	–	706,024
Total loans past due 90 days or more and still accruing interest	–	1,863,656	–

Past due and nonaccrual loans presented by loan class were as follows as of December 31, 2011 and 2010:

	Still Accruing		
December 31, 2011	30-89 Days Past Due	Over 90 Days Past Due	Nonaccrual
Commercial Real Estate:			
Construction and Land Development	$ –	$ –	$ –
Multifamily	–	–	–
Other	–	–	–
Residential Real Estate	–	–	–
Commercial	–	–	–
	$ –	$ –	$ –

	Still Accruing		
December 31, 2010	30-89 Days Past Due	Over 90 Days Past Due	Nonaccrual
Commercial Real Estate:			
Construction and Land Development	$ –	$1,863,656	$ –
Multifamily	–	–	–
Other	–	–	–
Residential Real Estate	–	–	–
Commercial	–	–	–
	$ –	$ 1,863,656	$ –

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, 2011 and December 31, 2010:

	December 31, 2011	December 31, 2010
Leasehold improvements	$ 294,469	$ 294,469
Furniture, fixtures and equipment	212,892	210,817
Software and capitalized data & item processing	145,660	145,660
Computer equipment	152,167	151,585
Automobile	20,282	20,282
Construction-in-progress	–	–
Total premises and equipment	825,470	822,813
Less accumulated depreciation and amortization	702,626	565,737
Premises and equipment, net	$ 122,844	$ 257,076

Depreciation and amortization expense of premises and equipment aggregated $138,632, $179,820 and $185,995 for the years ended December 31, 2011, December 31, 2010 and December 31, 2009, respectively.

Note 5. Income Taxes

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

	2011	2010	2009
Current:			
Federal	$ 875,287	$ 376,584	$ –
State	234,480	56,622	800
Total current	1,109,767	433,206	800
Deferred:			
Federal	(344,000)	(127,731)	–
State	(122,000)	(13,211)	–
Valuation Allowance Reversal	(733,000)	(337,000)	–
Total deferred	(1,199,000)	(477,942)	–
Total expense (benefit)	$ (89,233)	$ (44,736)	$ 800

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, 2011 and 2010:

	2011	2010
Pre-opening expenses	$ 82,000	$ 86,000
Stock-based compensation	164,000	164,000
OREO expenses	152,000	100,000
Loan loss reserve	1,126,000	743,000
Other	153,000	118,000
	1,677,000	1,211,000
Valuation allowance	–	(733,000)
Net deferred tax asset	$ 1,677,000	$ 478,000

Beginning in the year 2010 and continuing through 2011, the Bank demonstrated the ability to maintain a consistent level of profitability such that a 100% reserve against the net deferred tax assets is no longer necessary. Therefore, in 2010 and 2011, the valuation allowance on deferred tax assets was reversed in the amounts of $337,000 and $733,000, respectively. The deferred tax asset balance as of December 31, 2010 has been adjusted to reflect income tax return adjustments to the deferred amounts. Such adjustment has no net impact on tax expense as the adjustment is equally offset by a change in current income taxes payable or receivable.

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

	2011	2010	2009
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	-55.97	41.55
Other	6.94	7.39	–
	-6.67%	-7.43%	-.40%

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, 2011, respectively.

Note 6. Time Deposits

The aggregate amount of time deposit accounts equal to or greater than $100,000 was $19,057,867 and $15,064,544 at December 31, 2011 and December 31, 2010, respectively. At December 31, 2011 the scheduled maturities for time deposits were as follows (in thousands):

Due in 2012	$ 23,714
Due in 2013	2,650
Due in 2014	1,007
Due in 2015	735
Due in 2016	549
	$ 28,655

Interest expense on time deposits of $100,000 or more was $191,771, $233,531 and $287,864 in 2011, 2010 and 2009, 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. Total FHLB borrowings at December 31, 2011, and December 31, 2010, were $0 and $3,000,000, respectively, with a weighted average maturity of 53 days and a weighted average cost of 0.42% at December 31, 2010. At December 31, 2011, the Bank had a total available borrowing capacity of $34,315,400 which included $27,315,400 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.

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, 2008	480,700	$ 9.11
Granted 2009	6,600	8.98
Exercised 2009	–	–
Cancelled 2009	(3,300)	9.09
Balance at December 31, 2009	484,000	9.11
Granted 2010	3,300	6.50
Exercised 2010	–	–
Cancelled 2010	(19,800)	8.66
Balance at December 31, 2010	467,500	9.11
Granted 2011	3,300	6.73
Exercised 2011	–	–
Cancelled 2011	(22,000)	9.09
Balance at December 31, 2011	448,800	$ 9.09

	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, 2010:	467,500	6.78 years	$ 9.11	461,266	6.87 years	$ 9.10
December 31, 2011:	448,800	5.77 years	$ 9.09	443,300	5.84 years	$ 9.11

There was an aggregate intrinsic value of stock option awards outstanding and exercisable of $283,675 and $0, respectively, at December 31, 2011 and December 31, 2010.

The number and weighted average grant date fair value of options granted is as follows for the years ended December 31, 2011, December 31, 2010 and December 31, 2009:

	Number	Weighted Average Grant Date Fair Value
2009	6,600	$2.21
2010	3,300	$3.63
2011	3,300	$2.72

The weighted average assumptions used for 2011, 2010 and 2009 in determining the fair value of options granted are as follows:

	2011	2010	2009
Expected life (yrs.)	6	6	6
Volatility	35.28%	57.04%	15.00%
Risk free rate of return	3.44%	2.96%	3.46%
Dividend yield	0.00%	0.00%	0.00%

As of December 31, 2011, there was $11,381 unrecognized stock compensation expense that will be recognized through July 31, 2014.

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 $17,824 matching employee 401(k) contributions in 2011 and did not match employee contributions in 2010 or 2009.

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, 2011, and December 31, 2010.

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 $1,000,000 and $400,000 were maintained with correspondent banks at December 31, 2011 and December 31, 2010, respectively.

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:

2012	$151,200
2013	151,200
2014	151,200
2015	151,200
2016	151,200
2017	151,200
	$907,200

Building rent expense was $140,400 for each of the years ended December 31, 2011, December 31, 2010, and December 31, 2009.

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, 2011 and December 31, 2010 are as follows:

	December 31,	
	2011	2010
Commitments to extend credit	$13,811,511	$13,232,312
Total unfunded financial commitments	$13,811,511	$13,232,312

Legal Matters. At December 31, 2011, 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, 2011 and 2010 are the investment securities classified as available for sale totaling $7,106,750 and $2,719,871, 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, 2011, and December 31, 2010, consist solely of other real estate owned of $396,000 and $2,548,244, having a fair value assertion based on the Level 3 assumption.

As of December 31, 2011, 2010 and 2009, specific allocated reserves on OREO properties as well as write-downs on such properties aggregated $80,680, $87,603 and $0.

The were no changes in Level 3 assets and liabilities measured at fair value on a recurring basis for the year ended December 31, 2011.

The following table presents the carrying amounts and estimated fair values of the Bank's financial instruments at December 31, 2011 and December 31, 2010. 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, 2011		December 31, 2010	
	Amount	Fair Value	Amount	Fair Value
Financial Assets:				
Cash and cash equivalents	$ 21,304,988	$ 21,304,988	$ 18,031,690	$ 18,031,690
Interest-bearing deposits in other banks	28,280,805	28,280,805	24,698,574	24,698,574
Securities available-for-sale	7,106,750	7,106,750	2,719,871	2,719,871
Bankers' bank and Federal Home Loan Bank stock	594,597	594,597	581,373	581,373
Loans, net	83,092,951	82,132,657	66,854,841	66,382,096
Accrued interest receivable	329,595	329,595	320,781	320,781
Financial Liabilities:				
Noninterest-bearing demand deposits	$ 31,366,553	$ 31,366,553	$ 20,258,708	$ 20,258,708
Interest-bearing demand deposits	10,133,478	10,133,478	7,523,211	7,523,211
Money market deposits	50,166,365	50,166,365	43,843,032	43,843,032
Time certificates of deposit	28,654,544	28,655,326	22,228,043	22,228,304
Savings account deposits	3,561,268	3,561,268	2,325,836	2,325,836
Borrowings	–	–	3,000,000	3,000,000
Accrued interest payable	11,940	11,940	11,950	11,950

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, 2011 and December 31, 2010 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:

	2011	2010	2009
Other non-interest income:			
Gain on sale of assets	$ 89,644	$ 51,412	$ –
Wire transfer fees	7,000	5,655	3,855
Merchant card processing	4,353	5,131	4,082
Imprinted check sales	3,700	3,324	2,830
Internet banking fees	5,205	3,255	2,545
Safe deposit fees	2,800	2,450	1,950
Other non-interest income	33,447	12,325	17,487
Total other non-interest income	$ 146,149	$ 83,552	$ 32,749
Other operating expense:			
Other real estate owned expense	$ 124,239	$ 173,138	$ 10,368
Regulatory assessments	181,606	201,967	108,680
Directors' & organizers' stock-based compensation expense	–	94,250	113,100
Correspondent bank charges	52,111	82,256	93,694
Stationery, supplies and printing	23,136	26,653	23,217
Shareholder related expense	30,787	26,330	15,267
Insurance and security	26,360	25,951	26,061
Telephone, postage and electronic communications	23,241	21,732	20,197
Director fees	57,234	16,666	–
Loan and collection expense	16,053	10,263	91,030
Armored car and messenger	7,953	6,892	3,283
ATM surcharge fees	7,392	6,600	4,661
Publications and subscriptions	12,602	6,027	6,844
Meetings, conferences, education & training	5,713	3,944	2,199
Human resources administration fees	2,278	3,867	10,403
Dues and memberships	4,951	1,579	3,770
Customer checks and stamps	5,859	1,563	1,109
Other non-interest expenses	33,179	21,510	13,541
Total other operating expenses	$ 614,694	$ 730,828	$ 547,424

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, 2011, 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, 2011								
Total capital (to risk-weighted assets)	$19,879	20.11%	$ 7,907	8.00%	$ 9,884	10.00%	$ 9,884	10.00%
Tier 1 capital (to risk-weighted assets)	$18,623	18.84%	$ 3,953	4.00%	$ 5,930	6.00%	$ 5,930	6.00%
Tier 1 capital (to average assets) leverage ratio	$18,623	13.36%	$ 5,574	4.00%	$ 11,149	8.00%	$ 6,968	5.00%
As of December 31, 2010								
Total capital (to risk-weighted assets)	$18,232	22.01%	$ 6,627	8.00%	$ 8,283	10.00%	$ 8,283	10.00%
Tier 1 capital (to risk-weighted assets)	$17,185	20.75%	$ 3,313	4.00%	$ 4,970	6.00%	$ 4,970	6.00%
Tier 1 capital (to average assets) leverage ratio	$17,185	15.22%	$ 4,517	4.00%	$ 9,033	8.00%	$ 5,646	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)

Michael P. Dunn, D.O.
Physician
Watsonville Community Hospital

Craig A. French
Managing Director and
Chief Operating Officer
Redtree Properties, LP.

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

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
Burroughs Financial Services

Chairman, Foothill Securities, Inc.

Bruce A. McPherson
California's 30th Secretary of State
Past California State Senator, 15th District

James L. Weisenstein
President
Graystone Consulting, LLC.

I like the experience and personal feel of a hometown bank which Lighthouse Bank provides along with friendly, personal and professional service. I would not hesitate to recommend their services to my friends and colleagues. It is always a pleasure working with Lighthouse Bank!

John A.Hedrick, D.D.S., M.S.
Hedrick Orthodontics

Senior Management

(In order from left to right)

Donald H. Soman
Executive Vice President
Chief Financial Officer

Kimberly M. Raynal
Senior Vice President
Chief Operating Officer

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

Richard G. Hofstetter
President
Chief Executive Officer

Jon P. Sisk
Senior Vice President
Senior Lending Officer

The service we received while financing the purchase of our building was above and beyond. They went out of their way to accommodate us and their professionalism was stellar. We are pleased the service didn't end once the ink was dry.

Lawrence J. Spingola, M.D., F.A.C.S., Jimmy Y. Chung, M.D., F.A.C.S., and Brian J. Waddle M.D., F.A.C.S.
Surgical Associates of Monterey Bay

Staff

(In order from left to right)

Wendy Matlick
Assistant Vice President
Service Manager

Marshall Delk
Vice President
Business Development Officer

Dara Harris
Assistant Vice President
Loan Support Officer

Joey Garcia
Service Officer

Ruby Stiga
Client Service Representative

Robert Dennis
Vice President
Relationship Manager

Claudia Morales
Client Service Representative

Matthew Sinnott
Senior Client Service Representative

Lisa Ratliff
Senior Loan Servicing Specialist

Ivan Ditmars
Accounting Officer

Jamie Ganly
Vice President
Relationship Manager

Brianna Carabba
Vice President
Executive Administrator

Michelle Cole
Vice President
Note Department Manager

Judy Spellerberg
Senior Client Service
Representative

For small businesses, a bank should be more than a place to deposit or borrow money. Lighthouse Bank's team of trusted bankers have deep local roots and extensive small business experience, an indispensible resource for business owners, especially at formation and key stages of growth.

— David Jacobs
Chiorini, Hunt & Jacobs Certified Public Accountants, Inc.

Advisory Board

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Medical Director
Eye Care Medical
Group, Inc.

President and
Medical Director
Cypress Outpatient
Surgical Center

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Linda Burroughs
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Peter Gaarn &
Associates

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Hamilton Swift
& Associates

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Alan Heit
Family Dentistry

Sandra Hill
Sandra Hill
Fiduciary Services

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S.R.A.
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Matt Shelton
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Commercial
Real Estate

Sam Storey
Chief Executive Officer
Community Bridges

Ken Whiting
President
Whiting's Foods, Inc.

Lawrence Wolfsen
Owner
Wolfsen Properties

Shareholder Relations and Information

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

Market Makers

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Lisa Gallo
(866) 491-7828
Lisa.gallo@wedbush.com

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
Executive Administrator
Lighthouse Bank
111 Mission Street
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Phone: (831) 600-4007

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

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Chief Financial Officer
Lighthouse Bank
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LIGHTHOUSE BANK

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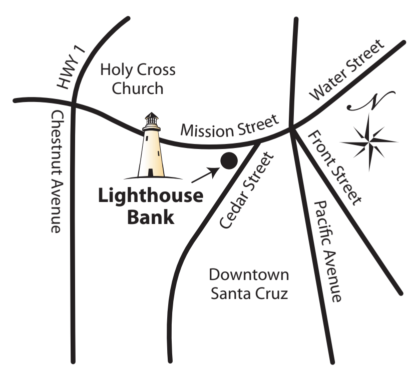

EQUAL HOUSING LENDER
Member FDIC


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BANK
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