2 0 0 8

ANNUAL REPORT

A SAFE PLACE TO BANK IN YOUR LOCAL COMMUNITY

Malaga Bank, now in our 25th year serving the South Bay, is a proven success story of strength and stability with a Bauer Financial Inc. five star rating. Our staff lives and works where you do and are involved in your community. Experience the kind of service, friendliness and commitment to the community that only a local bank can provide. We invite you to come in, enjoy a cup of gourmet coffee, meet our friendly and dedicated staff and let them customize banking solutions that meet your needs. We treat you like the neighbor you are!

Malaga Bank is a wholly owned subsidiary of Malaga Financial Corporation whose common stock is traded under CUSIP#561046103 MLGF.

Palos Verdes Estates Office Opened 1985

Torrance Office Opened 2005 (Temporary location)

Loan Center Office Opened 2009 – Now in our new location

Building on Success

In our 25th Year

Rolling Hills Estates Office Opened 1993

Torrance Office Opening Summer 2009 – Our new location

San Pedro Office Opened 2008

DEAR SHAREHOLDERS AND FRIENDS,

We are pleased to report that in spite of an extremely challenging year for the banking industry, Malaga Financial Corporation and Malaga Bank, its banking subsidiary, were able to report a 19% increase in net income in 2008, to $7,076,000, a record year. Based on the quarterly call report information compiled by D.A. Davidson & Co, Malaga Bank was ranked number 2 out of 95 banks and thrifts headquartered in the Los Angeles and Orange counties in profitability based on return on average equity.

We were able to continue to grow our assets, which increased 9% to $764 million at December 31, 2008 compared to $704 million at December 31, 2007. The loan portfolio at December 31, 2008 was $731 million, an increase of $58 million or 9% from December 31, 2007. Non-performing assets at December 31, 2008 consisted of one non-accrual consumer loan in the amount of $9,241.

At December 31, 2008, Malaga Bank was in compliance with all applicable regulatory capital requirements and was deemed "well-capitalized" under applicable regulations. Core capital and risk-based capital ratios were 8.49% and 13.74%, respectively, and exceeded the minimum "well-capitalized" requirements of 5.00% and 10.00%, respectively, at December 31, 2008.
Due to our already strong capital position, increased earnings and lack of non performing assets, we elected not to apply for capital augmentation provided by the Treasury Department for healthy institutions under the Capital Purchase Program (CPP).

In order to continue serving the South Bay community, our branch expansion plans continued in April 2008 with the opening of our San Pedro branch. In the summer of 2009, expansion of our full service branch at the corner of Crenshaw Boulevard and Rolling Hills Road is scheduled for completion.

In this volatile environment, it is our goal to provide a strong stable bank for our shareholders, employees, customers and the community. Malaga Bank continues to receive a five-star rating, the highest rating available from Bauer Financial. Now in its 25th year, Malaga Bank is a proven success story of strength and stability.

On behalf of Malaga Financial Corporation and Malaga Bank, we thank our board of directors, management and staff for their dedication to our continued success and we thank you, our shareholders, for your support, your business and your investment.

Randy C. Bowers
President and
Chief Executive Officer

Robert E. Kershaw
Chairman of the Board

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following discussion and financial information is presented to aid in understanding results of operations and financial condition of Malaga Financial Corporation ("MFC") and its consolidated subsidiary, Malaga Bank FSB ("Malaga Bank"). In this discussion, references to the "Company" or "we" or "us" refer to MFC and Malaga Bank.

OVERVIEW

MFC is the holding company for Malaga Bank, and the stock of Malaga Bank is MFC's primary asset. Malaga Bank is a full service community bank with headquarters located on the Palos Verdes Peninsula in Southern California. It is the largest independent bank headquartered in the South Bay area of Los Angeles.

We originate primarily adjustable rate multifamily (apartment) mortgage loans in Los Angeles and Orange counties and to a lesser extent single-family residential loans, consumer loans, construction loans, commercial mortgage loans and commercial loans. At December 31, 2008, multifamily mortgage loans represented 74% of our loan portfolio and loans represented 95% of our total assets.

In 2008, our market area for deposits continued to be concentrated in the areas immediately surrounding our four branch offices in Palos Verdes Estates, Rolling Hills Estates, Torrance and San Pedro, California. The San Pedro branch opened in April 2008.

RESULTS OF OPERATIONS

Our net income was $7.1 million in 2008 compared to net income of $6.0 million in the previous year, an increase of $1.1 million or 19%. Earnings per share for 2008 were $1.24 (basic and fully diluted), compared to $1.02 (basic) and $1.01 (fully diluted) in 2007.

Our return on average assets (ROA) was 0.97% in 2008 compared to 0.86% in 2007. Our return on average equity (ROE) was 13.94% in 2008 compared to 12.24% in 2007.

The following outlines certain key performance indicators over the past five years:

	2008	2007	2006	2005	2004
Total assets (000's)	$ 763,946	$ 703,972	$ 672,976	$ 581,493	$ 496,124
Stockholders' equity (000's)	$ 54,533	$ 48,633	$ 46,222	$ 42,449	$ 38,025
Net income (000's)	$ 7,076	$ 5,967	$ 5,213	$ 4,758	$ 5,394
Basic earnings per share	$ 1.24	$ 1.02	$ 0.90	$ 0.84	$ 1.00
Diluted earnings per share	$ 1.24	$ 1.01	$ 0.88	$ 0.81	$ 0.94
ROA	.97%	.86%	.82%	.89%	1.13%
ROE	13.94%	12.24%	11.67%	11.80%	15.26%

NET INTEREST INCOME

Net interest income is the primary component of our income. The chief determinants of net interest income are the dollar amounts of interest-earning assets and interest-bearing liabilities and the interest rates earned or paid thereon. The greater the excess of average interest-earning assets over average interest-bearing liabilities, the more beneficial the impact on net interest income.

Net interest income increased by $3.3 million in 2008 as a result of continued growth in interest-earning assets and an improvement in the interest rate spread. Average interest-earning assets (principally loans) increased $36 million (5%) from 2007. The interest rate spread (the difference between the weighted average yield on average interest-earning assets and the weighted average rate paid on average interest-bearing liabilities) increased from 2.29% in 2007 to 2.69% in 2008.

Our interest rate spread normally contracts during periods of rising interest rates due to an inherent lag as the rates on our loans adjust more slowly than the rates on our deposits and borrowings, resulting in lower net interest income until market interest rates stop increasing and the interest rates on the loans fully adjust. The opposite is true in a declining interest rate market where interest rate spreads widen until the market interest rates stabilize and interest rates on our loans fully adjust.

The yield on our loan portfolio decreased during most of 2008 due to interest rate decreases by the Federal Reserve Board starting in September 2007. Our costs of deposits and borrowings, which respond more quickly to changes in interest rates, reflected more of a decrease during most of 2008.

The following table sets forth the weighted average balances, yields earned and rates paid with respect to the major components of our interest-earning assets and interest-bearing liabilities, and net interest income, for the periods indicated:

WEIGHTED AVERAGE BALANCES

	YEARS ENDED DECEMBER 31	
	2008	**2007**
Loans	**$ 690,206,376**	$ 641,916,570
Federal funds sold	**2,517,188**	17,310,753
Interest-bearing deposits in banks	**8,184,360**	7,435,011
FHLB Stock	**14,639,688**	13,151,623
Interest-earning assets	**715,547,612**	679,813,957
Deposits	**353,338,683**	368,173,389
FHLB borrowings	**303,799,714**	253,376,839
Junior subordinated debentures	**13,404,000**	13,404,000
Interest-bearing liabilities	**670,542,397**	634,954,228
Excess of interest-earning assets over interest-bearing liabilities	**$ 45,005,215**	$ 44,859,729

WEIGHTED AVERAGE YIELDS EARNED AND RATES PAID

	2008	2007
Loans	**6.25%**	6.80%
Federal funds sold	**3.07**	4.87
Interest-bearing deposits in banks	**4.07**	5.30
FHLB stock	**3.94**	5.27
Total interest-earning assets	**6.17**	6.70
Deposits	**2.40**	3.92
FHLB borrowings	**4.63**	5.04
Junior subordinated debentures	**5.72**	6.05
Total interest-bearing liabilities	**3.48**	4.41
Interest rate spread	**2.69**	2.29
Net yield on interest-earning assets	**2.91**	2.58

PROVISIONS FOR LOAN LOSSES

We recorded provisions for loan losses of $329,000 in 2008 versus $124,000 in 2007. The increased provision was attributable to greater net loan growth (loan originations less amortizations and payoffs) of $59 million in 2008 versus $28 million in 2007. No loans were charged off in 2008 and we had only two delinquent consumer loans in the amount of $15,000 as of December 31, 2008.

OTHER OPERATING INCOME

Other operating income increased $41,000 due primarily to higher fees from increased levels of transaction accounts.

OTHER OPERATING EXPENSES

The main components of other operating expenses or “overhead” are compensation, office rent and utilities, regulatory

assessments and general and administrative expenses. Other operating expenses increased 14% from $7,804,000 in 2007 to $8,924,000 in 2008. Compensation expenses increased $749,000 due primarily to the opening of our new branch in San Pedro in April 2008. This branch also contributed to higher occupancy expense of $205,000 and increased depreciation expense of $106,000. Operating expenses also increased due to an increase of $80,000 in FDIC deposit insurance premiums.

We employed 68 full-time equivalent employees at December 31, 2008, many of whom have been employed by us for at least several years. The tenure and experience of our employees continue to be a major part of our successful and efficient operations.

Banks measure their ability to manage overhead through an efficiency ratio, i.e., total overhead expenses as a percentage of net interest income and other operating income. Malaga Bank's efficiency ratios of 40.50% in 2008 and 41.66% in 2007 continued to be very favorable compared to the efficiency ratios of our peers, which averaged 74.59% in 2008 and 77.07% in 2007. Another measure of overhead efficiency is the percentage of overhead expense to average assets. Malaga Bank's ratio was 1.22% in 2008 versus 1.11% in 2007, which compared with a peer group average of 2.48% and 2.46% in 2008 and 2007, respectively. Malaga Bank had $11.0 million in average assets per employee at December 31, 2008 as compared to $12.0 million in average assets per employee at December 31 2007.

FINANCIAL CONDITION

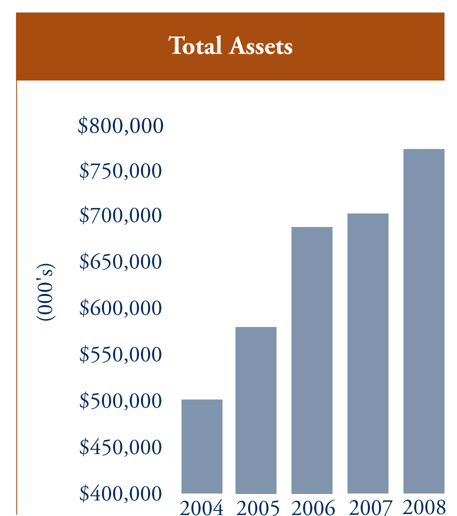
We continued to grow in 2008, as our total assets increased from $704 million at December 31, 2007 to $764 million at December 31, 2008.

LOAN PORTFOLIO

Total gross loans at December 31, 2008 were $731 million, up $58 million or 9% from the prior year-end. Our primary lending emphasis continued to be multifamily real estate loans, although multifamily loans as a percentage of our portfolio decreased from 77% at December 31, 2007 to 74% at December 31, 2008 due to increased focus on loans secured by single family residence. The weighted average yield of the loan portfolio was 6.25% at December 31, 2008 and 6.80% at December 31, 2007.

LOAN LOSS RESERVES AND NON-PERFORMING ASSETS

Our allowance for loan losses, including reserves for losses on commitments for lines of credit and construction loans, totaled $2.7 million at December 31, 2008 as compared to $2.4 million at December 31, 2007. We had one consumer loan in the amount of $9,000 that was classified as a non-performing asset at year-end 2008 and no non-performing assets at year-end 2007. Our allowance for loan losses to total loans outstanding was 0.38% at December 31, 2008 and 0.37% at December 31, 2007.



We continue to conservatively underwrite our real estate loans to maintain strong asset quality. We had only two delinquent consumer loans at December 31, 2008 in the amount of $15,000. We had no loan charge-offs in 2008 or 2007.

Management's determination of the adequacy of the allowance for loan losses requires the use of judgment and estimates that may change in the future. Some factors considered by management in determining the adequacy of the allowance include: detailed reviews of individual loans; gross and net charge-offs in the current year; historical loss levels; past due and non-accruing loans; collateral values of properties securing loans; types of loans and risk profiles; and management's analysis of current economic conditions and the resulting impact on the loan portfolio. Changes in the factors used by management to determine the adequacy of the allowance, or the availability of new information, could cause the allowance for loan losses to be increased or decreased. In addition, bank

regulatory agencies, as a part of their examination process, may require that additions be made to the allowance for loan losses based on their judgment and estimates.

DEPOSITS

Our deposit strategy in 2008 continued to focus on attracting relationships. Total deposits increased by $18 million to $368.7 million at December 31, 2008. During the year non-interest bearing demand deposits increased $6.7 million to $26.6 million and lower cost money market accounts increased $32.6 million, while higher cost certificates of deposit decreased $20.7 million. The increase in non-interest bearing deposits is primarily due to expansion of our branch system and increased focus on low cost deposits. At December 31, 2008, we had outstanding certificates of deposit from the State of California totaling $48 million at a weighted average rate of 1.03%. Our weighted average cost of deposits was 2.40% at December 31, 2008 compared to 3.92% at December 31, 2007.

FHLB BORROWINGS

Another major source of funding is advances from the Federal Home Loan Bank of San Francisco ("FHLB"). As of December 31, 2008, we had fixed rate FHLB advances totaling $267.2 million at a weighted-average rate of 4.78% and overnight variable rate advances totaling $55 million at a weighted-average rate of 0.05%. At that date, we had approximately $45 million of unused FHLB borrowing capacity.

JUNIOR SUBORDINATED DEBENTURES

From time to time we have issued junior subordinated debentures related to issuance of trust preferred securities by business trusts we formed in order to generate regulatory capital. This capital has a relatively low cost as interest payments on the debentures are deductible for income tax purposes. At December 31, 2008, we had $13.4 million junior subordinated debentures outstanding bearing interest at a weighted average rate of 4.88% per annum. These debentures mature commencing 2033.

STOCKHOLDERS' EQUITY AND REGULATORY CAPITAL

Our stockholders' equity grew by $5.9 million or 12% to $54.5 million at December 31, 2008, from $48.6 million at December 31, 2007. The increase was due principally to retained earnings of $7.1 million and proceeds from the exercise of stock options of $818,000, net of $1.8 million of dividends paid and common stock repurchases of $236,000.

Malaga Bank continues to be "well capitalized" under applicable regulations with its regulatory capital ratios increasing over the previous year. The following table compares Malaga Bank's actual capital ratios at December 31, 2008 to those required by regulatory agencies for capital adequacy and well capitalized classification purposes:

	Malaga Bank	Minimum Capital Requirements	Well Capitalized Requirements
Tier 1 Leverage Capital Ratio	8.49%	4.00%	5.00%
Tier 1 Risk Based Capital to Risk-Weighted Assets	13.19	N/A	6.00
Total Risk Based Capital to Risk-Weighted Assets	13.74	8.00	10.00

*Adjusted for Stock Dividends and Splits

SHAREHOLDERS AND STOCK INFORMATION

At December 31, 2008, MFC had 137 shareholders of record. Many of our shareholders purchased stock in connection with the organization of Malaga Bank. Our Board of Directors owns approximately 66.3% of the total outstanding shares. MFC's common stock is traded over-the-counter under the symbol MLGF.OB.

CONSOLIDATED BALANCE SHEETS

	DECEMBER 31	
	2008	**2007**
ASSETS		
Cash and due from banks	**$ 7,253,273**	$ 6,412,760
Federal funds sold	**3,063,828**	5,988,790
Cash and cash equivalents	**10,317,101**	12,401,550
Interest-bearing deposits in banks	**5,792,000**	6,146,142
Loans receivable, net of allowance for loan loss of $2,741,485 (2008) and $2,433,285 (2007)	**723,766,069**	665,115,490
Accrued interest receivable	**3,079,889**	3,486,422
Building, office properties and equipment—net	**4,411,336**	2,368,847
Investment in FHLB stock—at cost	**15,428,200**	13,439,800
Other assets	**1,151,080**	1,013,782
TOTAL	**$ 763,945,675**	$ 703,972,033
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES:		
Deposits:		
Noninterest-bearing	**$ 26,581,225**	$ 19,847,598
Interest-bearing	**342,085,388**	330,992,160
Total deposits	**368,666,613**	350,839,758
FHLB borrowings	**322,206,210**	285,769,982
Junior subordinated debentures	**13,404,000**	13,404,000
Accrued interest payable	**211,335**	344,369
Other liabilities	**2,661,599**	2,664,395
Deferred tax liability	**2,262,928**	2,316,456
Total liabilities	**709,412,685**	655,338,960
COMMITMENTS AND CONTINGENCIES (Note 4)		
STOCKHOLDERS' EQUITY:		
Common stock, $.001 par value—authorized, 20,000,000 shares; outstanding 5,733,712 shares (2008) and 5,661,768 shares (2007)	**5,734**	5,662
Additional paid-in capital	**12,876,333**	12,224,482
Retained earnings	**41,650,923**	36,402,929
Total stockholders' equity	**54,532,990**	48,633,073
TOTAL	**$ 763,945,675**	$ 703,972,033

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF OPERATIONS

	YEARS ENDED DECEMBER 31	
	2008	**2007**
INTEREST INCOME:		
Interest on loans	**$ 43,130,921**	$ 43,634,365
Interest on other investments	**986,939**	1,942,397
Total interest income	**44,117,860**	45,576,762
INTEREST EXPENSE:		
Deposits	**8,464,348**	14,446,758
Borrowings	**14,057,521**	12,759,083
Junior subordinated debentures	**766,279**	810,761
Total interest expense	**23,288,148**	28,016,602
NET INTEREST INCOME	**20,829,712**	17,560,160
PROVISION FOR LOAN LOSSES	**329,270**	124,200
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	**20,500,442**	17,435,960
OTHER OPERATING INCOME	**426,182**	385,379
OTHER OPERATING EXPENSE:		
Compensation	**4,741,704**	3,990,025
Office rent and utilities	**934,455**	726,991
Professional services	**235,440**	422,068
Data processing	**534,291**	492,823
Deposit insurance premiums	**122,541**	42,540
Depreciation and amortization	**243,987**	138,103
General and administrative	**2,111,503**	1,991,889
Total other operating expense	**8,923,921**	7,804,439
INCOME BEFORE INCOME TAXES	**12,002,703**	10,016,900
INCOME TAX EXPENSE	**4,926,354**	4,049,932
NET INCOME	**$ 7,076,349**	$ 5,966,968
BASIC EARNINGS PER SHARE	**$ 1.24**	$ 1.02
DILUTED EARNINGS PER SHARE	**$ 1.24**	$ 1.01

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007

	Common Stock					
	Number of Shares	Amount	Additional Paid-in Capital	Retained Earnings	Comprehensive Income	Total Stockholders' Equity
BALANCE—January 1, 2007	5,775,716	$ 5,776	$ 13,913,593	$ 32,302,611		$ 46,221,980
Net income				5,966,968	$ 5,966,968	5,966,968
Cash dividends				(1,866,650)		(1,866,650)
Common stock repurchased	(298,593)	(299)	(2,944,513)			(2,944,812)
Stock options exercised	184,645	185	711,150			711,335
Stock options compensation expense			89,252			89,252
Tax benefit from exercise of stock options			455,000			455,000
Total comprehensive income					$ 5,966,968	
BALANCE—December 31, 2007	5,661,768	5,662	12,224,482	36,402,929		48,633,073
Net income				7,076,349	$ 7,076,349	7,076,349
Cash dividends				(1,828,355)		(1,828,355)
Common stock repurchased	(24,847)	(25)	(236,021)			(236,046)
Stock options exercised	96,791	97	817,604			817,701
Stock options compensation expense			46,668			46,668
Tax benefit from exercise of stock options			23,600			23,600
Total comprehensive income					$ 7,076,349	
BALANCE—December 31, 2008	5,733,712	$ 5,734	$ 12,876,333	$ 41,650,923		$ 54,532,990

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR YEARS ENDED DECEMBER 31	2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	**$ 7,076,349**	$ 5,966,968
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of deferred loan fees—net of costs	**441,401**	207,220
FHLB stock dividends	**(748,000)**	(687,400)
Provision for loan losses	**329,270**	124,200
Loss on sale of equipment	**37**	1,306
Tax (benefit) related to exercise of stock options	**(23,600)**	(455,000)
Depreciation and amortization	**243,987**	153,104
Deferred income taxes	**(53,528)**	206,395
Stock option compensation expense	**46,668**	89,252
Net decrease (increase) in accrued interest receivable and other assets	**269,235**	(574,389)
Net (decrease) increase in accrued interest payable and other liabilities	**(122,337)**	338,501
Net cash provided by operating activities	**7,459,482**	5,370,157
CASH FLOWS FROM INVESTING ACTIVITIES:		
Net decrease in interest-bearing deposits in banks	**354,142**	1,281,000
Net increase in loans receivable	**(59,421,250)**	(27,818,301)
Proceeds from redemption of FHLB stock	**–**	131,200
Proceeds from sale of equipment	**–**	1,433
Purchase of FHLB stock	**(1,240,400)**	–
Purchase of premises and equipment	**(2,286,513)**	(443,995)
Net cash used in investing activities	**(62,594,021)**	(26,848,663)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase (decrease) in deposits	**17,826,855**	(6,232,947)
Net increase in FHLB borrowings	**36,436,228**	34,733,204
Stock repurchased	**(236,046)**	(2,944,812)
Dividends paid	**(1,818,248)**	(1,872,030)
Proceeds from exercise of stock options	**817,701**	711,335
Tax effect related to exercise of stock options	**23,600**	455,000
Net cash provided by financing activities	**53,050,090**	24,849,750
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	**(2,084,449)**	3,371,224
CASH AND CASH EQUIVALENTS—Beginning of year	**12,401,550**	9,030,306
CASH AND CASH EQUIVALENTS—End of year	**$ 10,317,101**	$ 12,401,550
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash paid during the year for:		
Interest	**$ 23,421,181**	$ 29,102,396
Income taxes	**$ 5,275,000**	$ 3,180,000
SUPPLEMENTAL SCHEDULE OF NONCASH FINANCING ACTIVITIES		
Dividend payable	**$ 473,690**	$ 463,583

See notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation and Presentation—
The consolidated financial statements include the accounts of Malaga Financial Corporation ("MFC") and its wholly owned subsidiary, Malaga Bank FSB (the "Bank") (collectively, the "Company"). All intercompany balances and transactions have been eliminated in consolidation.

MFC was formed on November 27, 2002, to operate as a holding company for the Bank. Effective June 19, 2003, each share of common stock of the Bank was converted into one share of $0.001 par value common stock of MFC and the Bank became a wholly owned subsidiary of MFC. The shareholders of the Bank became shareholders of the Company.

Nature of Operations—The Company's primary operations are related to traditional banking activities, including the acceptance of deposits and the lending and investing of money. The Company's customers consist of individuals and small-to-midsize businesses located primarily in the Palos Verdes Peninsula and adjoining areas of Los Angeles and Orange Counties. The Company operates through four branches, including its headquarters located in the city of Palos Verdes Estates.

Use of Estimates in the Preparation of Consolidated Financial Statements—The preparation of consolidated 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. Significant estimates include estimates of the allowance for loan losses.

Cash and Cash Equivalents— Cash and cash equivalents include cash and due from banks and overnight Federal funds sold, all of which have original maturities of less than 90 days at the time of purchase. The Company is required to maintain reserve balances with the Federal Reserve Bank under the Federal Reserve Act. The reserve balance was approximately $1,685,000 and $1,566,000 at December 31, 2008 and 2007, respectively.

Interest-Bearing Deposits in Banks—Interest-bearing deposits in banks mature within one year and are carried at cost.

Investment Securities—Debt securities that management has the positive intent and ability to hold to maturity are classified as "held to maturity" and recorded at amortized cost. Securities not classified as held to maturity or trading, including equity securities with readily determinable fair values, are classified as "available for sale" and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income, unless there is other-than-temporary impairment on the securities. The Company did not own any investment securities as of December 31, 2008 and 2007.

Investment in the stock of the Federal Home Loan Bank (FHLB) is not subject to classification in the aforementioned categories as it is not a readily marketable security and it is carried at cost.

Loans Receivable—Loans receivable are stated at unpaid principal balances plus premiums on purchased loans, less the allowance for loan losses and unamortized deferred loan origination fees and costs. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the loan yield using the interest method. Premiums on loans are amortized to income using the interest method over the remaining period to contractual maturity.

The accrual of interest on loans is discontinued at the time the loan is 90 days delinquent, unless the credit is well secured and in the process of collection. Loans are placed on nonaccrual or charged off at an earlier date, if collection of principal or interest is considered doubtful. All interest accrued but not collected for loans that are placed on nonaccrual or charged off are reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Loan fees and certain direct loan origination costs are deferred, and the net fee or cost is recognized as an adjustment to interest income using the interest method over the contractual life of the loans. Commitment fees and costs relating to commitments for which the likelihood of exercise is remote are recognized over the commitment period on a straight-line basis. If the commitment is subsequently exercised during the commitment period, the remaining unamortized commitment fee at the time of exercise is recognized over the life of the loan as an adjustment of yield. Other loan fees and charges, representing service costs for prepayment of loans, for delinquent payments or for miscellaneous loan services, are recorded as income when collected.

The Company's lending is concentrated in surrounding areas of Los Angeles and Orange Counties, and substantially all of the Company's loans have adjustable interest rates.

Allowance for Loan Losses**—**Management's periodic evaluation of the adequacy of the allowance is based on the Company's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect borrowers' ability to repay, estimated value of underlying collateral, and current economic conditions. Although management believes that the level of the allowance as of December 31, 2008, is adequate to absorb known and inherent risks in the loan portfolio, no assurances can be given that adverse future economic conditions will not lead to higher amounts of problem loans, provisions for credit losses, or charge-offs.

A loan is considered impaired when it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan. Impaired loans are measured based on the present value of expected future cash flows discounted at the loans' effective interest rates or the fair value of the collateral, if the loans are collateral dependent. If the fair value of an impaired loan is less than the carrying value, a specific reserve is included in the allowance for loan losses. Impairment is measured on a loan-by-loan basis for construction and commercial loans. Large groups of smaller balance homogenous loans are collectively evaluated for impairment.

Office Properties and Equipment**—**Leasehold improvements and furniture, fixtures, and equipment are carried at cost, less accumulated depreciation and amortization. Furniture, fixtures, and equipment are depreciated using the straight-line method over the estimated useful lives of the assets (three to seven years). The cost of leasehold improvements is being amortized using the straight-line method over the terms of the related leases or the estimated lives of the improvements, whichever is shorter.

Real Estate Owned**—**Real estate acquired through foreclosure is stated at the lower of cost or fair value, less estimated selling costs. Any subsequent holding costs and gains or losses on disposition of real estate owned are recorded in current operations. Substantial capital improvements are recorded as additions to cost of the real estate. Reductions in fair value identified subsequent to foreclosure are recognized in an allowance for losses on real estate owned. The Company did not have any real estate owned as of December 31, 2008 and 2007.

Impairment of Long-Lived Assets**—**Long-lived assets are reviewed at least annually for impairment. When impairment is indicated, the amount of impairment is the excess of the asset's net book value over its fair value. Furthermore, long-lived assets to be disposed of are reported at the lower of historical cost or fair value, less cost to sell.

Income Taxes**—**The Company utilizes the liability method in accounting for income taxes. Deferred tax assets or liabilities shown on the balance sheets reflect the tax effects of differences between the tax bases of assets and liabilities and their reported amounts in the financial statements.

Earnings Per Share—Basic earnings per share are determined by dividing net income by the average number of shares of common stock outstanding, while diluted earnings per share are determined by dividing net income by the average number of shares of common stock outstanding, adjusted for the dilutive effect of common stock equivalents.

Dividends—The Company paid dividends of $0.32 per share of common stock in each of 2008 and 2007.

Stock-Based Compensation—The Company issued stock-based compensation to certain employees, officers, and directors. Prior to December 31, 2005, the Company accounted for its stock options using the intrinsic-value method, presented in APB Opinion 25, *Accounting for Stock Issued to Employees*, which generally does not result in compensation expense recognition. Under the intrinsic value method, compensation cost for stock options is measured at the date of grant as the excess, if any, of the quoted market price of the Company's stock over the exercise price of the options. On January 1, 2006, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 123R, *Share-Based Payment*, for stock based compensation. SFAS No. 123R allows for two alternative transition methods. The Company follows the modified prospective method, which requires application of the new statement to new awards and to awards modified, repurchased, or cancelled after the required effective date. Accordingly, prior period amounts have not been restated. Additionally, compensation cost for the portion of awards for which the requisite service has not been rendered that are outstanding as of January 1, 2006, are recognized as the requisite services are rendered on or after January 1, 2006. The compensation cost of that portion of awards is based on the grant-date fair value of those awards as calculated for pro forma disclosures under the original SFAS No. 123.

Recent Accounting Pronouncements—The Company's financial statements as of December 31, 2007 disclosed that the Financial Accounting Standards Board ("FASB") Interpretation No. 48: *Accounting for Uncertainty in Income Taxes – an Interpretation of FASB No. 109* ("FIN 48") would be adopted in the year beginning January 1, 2008. In December 2008, the FASB issued FASB Staff Position (FSP) No. FIN48-3, Effective *Date of FASB Interpretation No. 48 for Certain Nonpublic Enterprises*. The adopted FSP amends FIN 48 by deferring implementation of FIN 48 to fiscal years beginning after December 15, 2008 for nonpublic enterprises. The FASB also believes this deferral will give it time to amend the disclosure requirements of FIN 48 for nonpublic enterprises. Therefore, the Company has deferred implementation of FIN 48 until the fiscal year beginning January 1, 2009.

Upon adoption of FIN48, the Company will evaluate positions taken or expected to be taken in a tax return and recognize the effect in the financial statements when it is more likely than not that the position would be sustained upon examination by tax authorities. A recognized tax position is then measured at the largest amount of benefit that is greater than 50% likely of being realized upon ultimate settlement. Upon adoption, the cumulative effect of applying the recognition and measurement provisions of FIN 48, if any, would be reflected as an adjustment to the opening balance of the Company's retained earnings.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, which provides a definition of fair value, establishes a framework for measuring fair value, and requires expanded disclosures about fair value measurements. The standard applies when GAAP requires or allows assets or liabilities to be measured at fair value, and therefore does not expand the use of fair value in any new circumstance. SFAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an arm's length transaction between market participants in the markets where we conduct business. SFAS 157 clarifies that fair value should be based on the assumptions market participants would use when pricing an asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. The fair value hierarchy gives the highest priority to quoted prices available in active markets and the lowest priority to data lacking transparency. The level of the reliability of inputs utilized for fair value calculations drives the extent of disclosure requirements of the valuation methodologies used under the standard. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those years. The provisions of SFAS 157 should be applied prospectively, except for certain financial instruments for which the standard

should be applied retrospectively. The adoption of this guidance has not had a material impact to the Company's financial condition and results of operations.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities — Including an amendment of FASB Statement No. 115*. SFAS No. 159 would allow the Company a one-time irrevocable election to measure certain financial assets and liabilities on the balance sheet at fair value and report the unrealized gains and losses on the elected items in earnings at each subsequent reporting date. This statement requires companies to provide additional information that will help investors and other users of financial statements to more easily understand the effect of the Company's choice to use fair value on its earnings. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Company has elected not to measure any new financial instruments at fair value, as permitted in SFAS No. 159, but to continue recording its financial instruments in accordance with current practice.

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations*, which replaces FASB Statement No. 141, *Business Combinations*. SFAS 141(R) establishes principles and requirements for how an acquiring company (1) recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree, (2) recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase, and (3) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS 141(R) is effective for business combinations occurring on or after the beginning of the fiscal year beginning on or after December 15, 2008. SFAS 141(R), effective for the Company on January 1, 2009, applies to all transactions or other events in which the Company obtains control in one or more businesses. Management will assess each transaction on a case-by-case basis as they occur.

In October 2008, the FASB issued FSP SFAS 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active*. FSP SFAS 157 157-3 clarified the application of SFAS 157 in an inactive market. It demonstrated how the fair value of a financial asset is determined when the market for that financial asset is inactive. FSP SFAS 157-3 was effective upon issuance. The adoption of this guidance did not have a material effect on the Company's financial condition, results of operations, or cash flows.

2. LOANS RECEIVABLE

At December 31, 2008 and 2007, loans receivable are summarized as follows:

Description	2008	2007
Residential mortgage loans–multifamily	**$ 537,288,081**	$ 512,597,674
Residential mortgage loans–single family	**118,979,400**	94,722,711
Commercial loans	**49,704,344**	48,799,974
Construction	**19,590,300**	11,892,696
Business banking loans	**3,858,045**	3,601,602
Land loans	**1,500,000**	1,500,000
Consumer loans	**452,463**	465,341
	731,372,633	673,579,998
Less (plus):		
Allowance for loan losses–general	**2,732,244**	2,433,285
Allowance for loan losses–specific	**9,241**	–
Construction loans in process	**7,269,932**	8,055,525
Deferred loan costs–net of fees	**(2,404,853)**	(2,024,302)
	7,606,564	8,464,508
	$ 723,766,069	$ 665,115,490

As of December 31, 2008 and 2007, loans with adjustable rates of interest (including loans with an initial fixed rate for 1 to 10 years which subsequently convert to adjustable rate) totaled $725.8 million and $667.0 million, respectively, and loans with fixed rates of interest were $5.6 million and $6.6 million, respectively. Adjustable-rate loans are generally indexed to the FHLB's Eleventh District Cost of Funds Index, 12 Month Constant Maturity Index or Prime Rate, and are subject to limitations on the timing and extent of adjustment. Most adjustable rate loans adjust within six months of changes in the index.

At December 31, 2008 and 2007, real estate loans aggregating $584.3 million and $406.1 million, respectively, were pledged as collateral against FHLB borrowings and real estate loans totaling $72.5 million and $63.8 million were pledged to secure deposits held by the State of California, respectively. In addition, construction loans totaling $12.3 million and home equity lines of credit totaling $20.4 million were pledged as collateral to the Federal Reserve Bank discount window at December 31, 2008.

Activity in the allowance for loan losses and unfunded loan commitments for the years ended December 31, 2008 and 2007 is summarized as follows:

	2008	**2007**
Allowance for loan losses:		
Balance–beginning of year	**$ 2,433,285**	$ 2,294,085
Provision for loan losses	**308,200**	139,200
Balance–end of year	**$ 2,741,485**	$ 2,433,285

Allowance for unfunded loan commitments:		
Balance–beginning of year	**$ 39,730**	$ 54,730
Provision (reversal) for unfunded loan commitments	**21,070**	(15,000)
Balance–end of year	**$ 60,800**	$ 39,730

The allowance for unfunded loan commitments is primarily related to undisbursed funds on construction loans and lines of credit. The Company evaluates credit risk associated with the loan portfolio at the same time it evaluates credit risk associated with the unfunded loan commitments. However, the allowances necessary for the commitments are reported separately in other liabilities in the accompanying consolidated balance sheets, and not as part of the allowance for loan losses, as presented above.

There was one non-accrual consumer loan in the amount of $9,241 considered impaired with a specific reserve of $9,241 at December 31, 2008. There were no loans considered to be impaired at December 31, 2007. The average recorded investment in impaired loans during the years ended December 31, 2008 and 2007 was $770 and $0, respectively. Interest income of $903 and $0 was recognized on impaired loans during the years ended December 31, 2008 and 2007, respectively, all of which was received in cash.

The Company is subject to numerous lending-related regulations and may not make real estate loans to one borrower in excess of 15% of its unimpaired capital and surplus, except for loans not to exceed $500,000. This 15% limitation results in a dollar limitation of approximately $10,105,000 at December 31, 2008.

In the ordinary course of business, the Company has granted loans to certain executive officers and directors and the companies with which they are associated. In management's opinion, such loans and commitments to lend were made under terms and prevailing interest rates that are consistent with the Company's normal lending policies. Interest income from loans to executive officers and directors was $525,932 and $383,000 in 2008 and 2007, respectively.

A summary of related-party loan activities for the years ended December 31, 2008 and 2007, is as follows:

	2008	**2007**
Beginning balance	**$ 8,198,723**	$ 6,172,065
Credit granted–including renewals	**3,522,972**	6,903,977
Less: Construction loans in progress	**(439,417)**	(1,706,699)
Repayments	**(3,055,266)**	(3,170,620)
Ending balance	**$ 8,227,012**	$ 8,198,723

3. BUILDING, OFFICE PROPERTIES AND EQUIPMENT

Building, office properties and equipment at December 31, 2008 and 2007, are summarized as follows:

	2008	**2007**
Land	**$ 1,275,364**	$ 1,275,364
Leasehold improvements	**1,693,575**	944,344
Equipment	**1,441,206**	1,122,685
Furniture and fixtures	**536,970**	443,259
Construction in progress (branch building)	**1,721,646**	598,423
	6,668,761	4,384,075
Accumulated depreciation and amortization	**(2,257,425)**	(2,015,228)
	$ 4,411,336	$ 2,368,847

Construction in progress consists primarily of costs associated with the building of a new retail branch in Torrance, California. The new branch is expected to be completed in the third quarter of 2009.

Depreciation and amortization expense for the years ended December 31, 2008 and 2007 was $243,987 and $153,104, respectively.

4. COMMITMENTS AND CONTINGENCIES

***Off-Balance-Sheet Financial Instruments*—**The Company 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, standby letters of credit, and financial guarantees. The Company's maximum exposure to credit loss under standby letters of credit, financial guarantees, and commitments to extend credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

The Company requires collateral to support financial instruments when it is deemed necessary. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained upon extension of credit is based on management's credit evaluation of the counterparty. Collateral held varies but generally includes real estate or deposits held in the Company.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses, and may require payment of a fee. Some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company had commitments to originate loans of $6.6 million and $8.0 million, undisbursed funds for construction loans of $7.3 million and $8.1 million, and undrawn lines of credit previously granted of approximately $34.8 million and $34.2 million at December 31, 2008 and 2007, respectively.

From time to time, the Company enters into certain types of contracts that contingently require the Company to indemnify parties against third-party claims and other obligations customarily indemnified in the ordinary course of the Company's business. The terms of such obligations vary, and generally, a maximum obligation is not explicitly stated. Therefore, the overall maximum amount of the obligations cannot be reasonably estimated. The most significant of these contracts relate to certain agreements with the Company's officers and directors under which the Company may be required to indemnify such persons for liabilities arising out of their performance of services for the Company. Historically, the Company has not been obligated to make payments for these obligations and no liabilities have been recorded for these obligations on its balance sheet as of December 31, 2008 and 2007.

Collateralized standby letters of credit and financial guarantees written are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Management does not anticipate any material losses as a result of these transactions. Loan commitments collateralized by standby letters of credit and financial guarantees written were $27,500 and $94,300 at December 31, 2008 and 2007, respectively.

***Leases*—**The Company leases office premises under operating leases that expire at various dates through September 24, 2022. Rental expense was $656,229 and $497,184 for the years ended December 31, 2008 and 2007, respectively.
The projected minimum rental payments under the terms of the leases at December 31, 2008, are as follows:

Years Ending December 31	
2009	$ 549,294
2010	343,170
2011	285,552
2012	285,552
2013	285,552
Thereafter	1,493,730
	$ 3,242,850

5. DEPOSITS

Deposit balances and the weighted average interest rates for each category at December 31, 2008 and 2007, are summarized as follows:

	2008		2007	
	Interest Rate	**Amount**	**Interest Rate**	**Amount**
Demand deposits	**0.00%**	**$ 26,581,225**	0.00%	$ 19,847,598
NOW accounts	**0.45**	**32,507,448**	0.46	36,457,297
Passbooks	**1.06**	**12,523,356**	1.68	9,410,713
Money market accounts	**1.14**	**89,151,457**	3.18	56,559,730
Certificates of deposit–non jumbo	**2.35**	**76,997,446**	4.50	83,960,397
Certificates of deposit–jumbo	**1.92**	**130,905,681**	4.33	144,604,023
		$ 368,666,613		$ 350,839,758

Jumbo certificates of deposit are certificates of deposit with balances of $100,000 or more.

Certificate of deposit maturities at December 31, 2008, are summarized as follows:

Years Ending December 31	
2009	$ 206,432,806
2010	1,229,951
2011	–
2012	240,370
	$ 207,903,127

As of December 31, 2008 and 2007, the Company had certificates of deposit from the State of California Treasurer's Office of $48,000,000 and $40,000,000, respectively.

6. FHLB BORROWINGS

A primary alternate funding source for the Company is a credit line with the FHLB San Francisco of up to 50% of the Company's total assets. Interest is payable monthly at a weighted average rate of 3.98% as of December 31, 2008 and are collateralized by real estate loans (see Note 2) and the capital stock of the FHLB owned by the Company.

Maturities of FHLB borrowings at December 31, 2008, are summarized as follows:

Years Ending December 31	
2009	$ 94,206,210
2010	44,000,000
2011	62,000,000
2012	32,000,000
2013	35,000,000
Thereafter	55,000,000
	$ 322,206,210

7. JUNIOR SUBORDINATED DEBENTURES

MFC has from time to time issued junior subordinated debentures related to concurrent issuances of trust preferred securities by business trusts formed by MFC in order to generate regulatory capital for the Bank. This capital has a relatively low cost as interest payments on the debentures are deductible for income tax purposes.

In June 2003, MFC issued $5,155,000 of junior subordinated debentures to PVP Statutory Trust I. This trust purchased the debentures with the proceeds of the sale of its common trust securities to MFC for $155,000 and trust preferred securities in a private placement for $5,000,000. The debentures and trust preferred securities have generally identical terms, including that they mature in June 2033, have been redeemable at par at MFC's option since June 2008, and require quarterly distributions/interest payments at a fixed rate of 5.67% per annum through June 2008 and thereafter at a variable rate that adjusts quarterly at the three-month LIBOR rate plus 3.10%. The interest rate on the debentures was 4.57% per annum at December 31, 2008.

In January 2005, MFC issued $2,578,000 of junior subordinated debentures to PVP Statutory Trust II. This trust purchased the debentures with the proceeds of the sale of its common trust securities to MFC for $78,000 and trust preferred securities in a private placement for $2,500,000. The debentures and trust preferred securities have generally identical terms, including that they mature in March 2035, are redeemable at par at MFC's option commencing March 2010,

and require quarterly distributions/interest payments at a rate that adjusts quarterly at the three-month LIBOR rate plus 1.77%. The interest rate on the debentures was 3.77% per annum at December 31, 2008.

In January 2005, MFC also issued $5,671,000 of junior subordinated debentures to PVP Statutory Trust III. This trust purchased the debentures with the proceeds of the sale of its common trust securities to MFC for $171,000 and trust preferred securities in a private placement for $5,500,000. The debentures and trust preferred securities have generally identical terms, including that they mature in March 2035, are redeemable at par at MFC's option commencing March 2010, and require quarterly distributions/interest payments at a fixed rate of 5.67% though March 2010 and thereafter at a variable rate that adjusts quarterly at the three-month LIBOR rate plus 1.77%. The interest rate on the debentures was 5.67% per annum at December 31, 2008.

MFC's investment in the common trust securities of the trusts is included in "other assets" on its balance sheets. MFC has unconditionally guaranteed distributions on, and payments on liquidation and redemption of, all of these trust preferred securities.

8. INCOME TAXES

A summary of income tax expense (benefit) for the years ended December 31, 2008 and 2007 is as follows:

	2008	2007
Current:		
State	**$ 1,195,069**	$ 1,013,755
Federal	**3,784,813**	2,829,782
	4,979,882	3,843,537
Deferred:		
State	**49,574**	77,630
Federal	**(103,102)**	128,765
	(53,528)	206,395
	$ 4,926,354	$ 4,049,932

The components of the net deferred tax (liability) asset at December 31, 2008 and 2007 are as follows:

	2008	2007
FEDERAL		
Deferred tax liabilities:		
Loan fees/costs	**$ (1,897,702)**	$ (1,785,147)
FHLB dividends	**(1,309,810)**	(1,113,800)
Depreciation	-	(32,880)
Other	**(51,738)**	(34,928)
Gross deferred tax liability	**(3,259,250)**	(2,966,755)
Deferred tax assets:		
California franchise tax	**639,321**	522,455
Depreciation	**32,862**	-
Bad debt and loan loss deduction	**932,105**	719,959
Other	**84,419**	50,696
Gross deferred tax asset	**1,688,707**	1,293,110
Net deferred tax liability	**$ (1,570,543)**	$ (1,673,645)

	2008	2007
STATE		
Deferred tax liabilities:		
Loan fees/costs	**$ (605,032)**	$ (569,147)
FHLB dividends	**(417,597)**	(355,105)
Depreciation	-	-
Other	**(5,787)**	(6,819)
Gross deferred tax liability	**(1,028,416)**	(931,071)
Deferred tax assets:		
California franchise tax	-	-
Depreciation	**22,648**	7,539
Bad debt and loan loss deduction	**297,177**	268,075
Other	**16,206**	12,646
Gross deferred tax asset	**336,031**	288,260
Net deferred tax liability	**$ (692,385)**	$ (642,811)

A deferred tax liability has not been provided for tax bad debt and loan loss reserves that arose in tax years prior to December 31, 1987. The Company had $239,000 of such reserves at December 31, 2008, for which $81,000 of taxes has not been provided. If these reserves were used for any purpose other than to absorb bad debt losses, federal taxes would have to be provided at the then-current income tax rate. It is not

contemplated that the accumulated reserves will be used in a manner that will create such liabilities.

A reconciliation of total income tax expense for 2008 and 2007 to the expected tax expense computed by applying the statutory corporate income tax rate to pretax income is as follows for the year ended December 31:

	2008		2007	
	Amount	**Percent**	**Amount**	**Percent**
Tax expense at statutory rates	**$ 4,200,946**	**35%**	$ 3,506,066	35%
State franchise tax– net of federal benefit	**821,465**	**7**	720,315	7
Other	**(96,057)**	**(1)**	(176,449)	(2)
	$ 4,926,354	**41%**	$ 4,049,932	40%

9. REGULATORY CAPITAL

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by the regulators that, if undertaken, could have a direct material effect on the Company's and the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities, and certain off balance sheet items that are calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weighting, and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined) and of Tier 1 capital (as defined) to average assets (as defined). As of December 31, 2008 and 2007, the Bank met all applicable regulatory capital requirements.

As of December 31, 2008 and 2007, the most recent notification from the Office of Thrift Supervision categorized the Bank as "well capitalized" under the regulatory framework for prompt corrective action. To be categorized as "well capitalized", the Bank must maintain minimum total risk-based, Tier 1 risk based and Tier 1 leverage ratios as set forth in the table below.

There are no conditions or events since that notification which management believes have changed the Bank's category.

	Actual		For Capital Adequacy Purposes		To Be Categorized As Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
As of December 31, 2008:						
Total capital to risk-weighted assets:	$ 67,366,151	13.74%	$ 39,212,888	8.00%	$ 49,016,110	10.00%
Core capital to adjusted tangible assets:	64,633,907	8.49	30,462,198	4.00	38,077,748	5.00
Tangible capital to adjusted tangible assets:	64,633,907	8.49	11,423,324	1.50	N/A	N/A
Tier 1 capital to risk-weighted assets:	64,633,907	13.19	N/A	N/A	29,409,666	6.00
As of December 31, 2007:						
Total capital to risk-weighted assets:	$ 59,563,640	12.79%	$ 37,249,437	8.00%	$ 46,461,797	10.00%
Core capital to adjusted tangible assets:	57,130,356	8.15	28,034,919	4.00	35,043,649	5.00
Tangible capital to adjusted tangible assets:	57,130,356	8.15	10,513,095	1.50	N/A	N/A
Tier 1 capital to risk-weighted assets:	57,130,356	12.27	N/A	N/A	27,937,078	6.00

10. STOCK OPTION PLANS

The Company has in effect two stock option plans, the 2003 Stock Option Plan (the"2003 Plan") and the 2007 Director Stock Option Plan (the "2007 Director Plan"). The 2003 Plan authorizes the Company to issue to officers, directors, employees and consultants of the Company up to 348,115 shares of the common stock upon exercise of options. The exercise price of the options granted under the 2003 Plan may not be less that the fair market value of the common stock on the date of grant and the term of any option may not exceed ten years.

Under the 2007 Director Plan, the Company may issue up to 300,000 shares of common stock pursuant to automatic grants to each director on January 1 of each year of an option to purchase 9,200 shares of common stock. The exercise price of each option granted under the 2007 Director Plan is the fair market value of the common stock on the date the option is granted. Each option granted under the 2007 Director Plan vests one year from the date the option was granted and expires five years from the date of grant, subject to earlier termination if the optionee ceases to be a director.

Pursuant to the adoption of SFAS No. 123R, stock based compensation expense was $46,668 and $89,252 for 2008 and 2007, respectively, which decreased the year's income before taxes by such amount and its effect on basic and diluted earnings per share, was negligible. Cash provided by operating activities decreased by $23,600 and $455,000 for 2008 and 2007, respectively and cash provided by financing activities increased by identical amounts for both 2008 and 2007, related to excess tax benefits from stock-based arrangements.

The following table presents the status of all optioned shares and exercise price amounts:

	Number of Options	Weighted-Average Exercise Price	Weighted-Average Term	Aggregate Intrinsic Value
Outstanding—beginning of year	347,452	$ 10.03		
Granted	55,200	9.70		
Exercised	(96,791)	8.45		
Canceled	(26,262)	11.00		
Outstanding—end of year	279,599	$ 10.48	2.92 years	$ 181,957
Vested and expected to vest—year end	224,399	$ 10.67	2.65 years	$ 165,397
Exercisable—year end	224,399	$ 10.67	2.65 years	$ 165,397

Information pertaining to options outstanding at December 31, 2008, is as follows:

Range of Exercise Prices	Number Outstanding	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number Exercisable	Weighted-Average Exercise Price
$3.86	1,167	1.0	$ 3.86	1,167	$ 3.86
$4.00 – $7.62	45,185	3.4	6.50	45,185	6.50
$9.70 – $12.96	233,247	2.8	11.28	178,047	11.77
	279,599	2.9	$ 10.48	224,399	$ 10.67

During the years ended December 31, 2008 and 2007, information related to stock options is presented as follows:

	2008	2007
Weighted-average fair value of stock options granted during the year	$ 0.70	$ 0.97
Total intrinsic value of options exercised	150,224	857,556
Total fair value of shares vested	44,240	89,095

As of December 31, 2008, total unrecognized compensation costs related to stock options that have been granted prior to the end of 2008 decreased to $20,280 from $66,948 due to $46,668 compensation expense cost recognized. This cost is expected to be recognized over a weighted-average period of 1 month.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions:

	2008	2007
Expected term (1)	1 year	1 year
Expected volatility (2)	18.77%	21.40%
Expected dividend yield (3)	3.30	2.89
Risk-free interest rate (4)	3.31	4.97

(1) The expected term is the vesting period of the option.
(2) The expected volatility was based on historical volatility for a period equal to the stock option's expected term.
(3) The expected dividend yield is based on the Company's prevailing dividend rate at the time of grant.
(4) The risk-free rate is based on the U.S. Treasury strips in effect at the time of grant equal to the stock option's expected term.

11. REPURCHASE OF COMMON STOCK

On September 9, 2008, the Company repurchased from a former executive officer 24,847 shares of common stock for a total purchase price of $236,046.

12. EARNINGS PER SHARE

The following is a reconciliation of the numerator and denominator of the basic and diluted earnings per share computation for the years ended December 31:

	2008			2007		
	Income (Numerator)	Shares (Denominator)	Per-Share Amount	Income (Numerator)	Shares (Denominator)	Per-Share Amount
Basic EPS						
Income available to common stockholders	$ 7,076,349	5,694,988	$ 1.24	$ 5,966,968	5,849,778	$ 1.02
Effect of Dilutive Securities						
Options–common stock equivalent		17,082	0.00		35,804	(0.01)
Diluted EPS						
Income available to common stockholders, plus assumed conversion	$ 7,076,349	5,712,070	$ 1.24	$ 5,966,968	5,885,582	$ 1.01

13. ESTIMATED FAIR VALUE INFORMATION

The Company adopted SFAS 157 effective January 1, 2008. SFAS 157 provides a framework for measuring fair value under GAAP. This standard applies to all financial assets and liabilities that are being measured and reported at fair value on a recurring and non-recurring basis. For the Company, this does not include any financial assets or liabilities.

As defined in SFAS 157, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In determining fair value, the Company may use various

methods including market and income approaches. Based on these approaches, the Company often utilizes certain assumptions that market participants would use in pricing the asset or liability. These inputs can be readily observable, market corroborated, or generally unobservable firm inputs. The Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. Based on the observability of the inputs used in the valuation techniques, the Company is required to provide the following information according to the fair value hierarchy. The hierarchy ranks the quality and reliability of the information used to determine fair values. The hierarchy gives the highest priority to quoted prices available in active markets and the lowest priority to data lacking transparency. Financial assets and liabilities carried at fair value will be classified and disclosed in one of the following three categories:

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 in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; or other inputs that are observable or can be derived from or corroborated by observable market data by correlation or other means.

Level 3: Significant unobservable inputs that reflect the reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

At December 31, 2008, there were no financial assets or liabilities measured or reported at fair value.

Financial assets and liabilities recorded at carrying value have estimated fair value amounts determined by the Company using available market information and appropriate valuation methodologies. However, considerable judgment is required to interpret market data to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Company could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts at December 31:

	2008		2007	
	Carrying Amount	**Fair Value**	**Carrying Amount**	**Fair Value**
Assets:				
Cash and cash equivalents	$ 10,317,101	$ 10,317,101	$ 12,401,550	$ 12,401,550
Interest-bearing deposits in banks	5,792,000	5,792,000	6,146,142	6,146,142
Loans receivable	723,766,069	721,152,000	665,115,490	661,675,490
Accrued interest receivable	3,079,889	3,079,889	3,486,422	3,486,422
Investment in FHLB stock	15,428,200	15,428,200	13,439,800	13,439,800
Liabilities:				
Deposits	$ 368,666,613	$ 369,289,000	$ 350,839,758	$ 353,190,758
FHLB borrowings	322,206,210	337,374,000	285,769,982	285,794,982
Junior subordinated debentures	13,404,000	13,404,000	13,404,000	13,400,000
Accrued interest payable	211,335	211,335	344,369	344,369

The methods and assumptions used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value are explained below.

For cash and cash equivalents, and accrued interest receivable and payable, the carrying amounts are considered to be their estimated fair value.

For interest-bearing deposits in banks, carrying amounts are considered to be estimated fair value due to the short-term nature of the deposits.

For FHLB stock, the carrying amount equals fair value, as the stock may be sold back to the FHLB at the carrying value.

The fair value of performing variable and fixed rate loans was estimated by discounting the remaining contractual cash flows using the estimated current rate at which similar loans would be made to borrowers with similar credit risk characteristics over the same remaining maturities, reduced by net deferred loan origination fees and the allocable portion of the allowance for loan losses. The estimated current rate for discounting purposes was not adjusted for any change in borrowers' credit risk since the origination of such loans. Rather, the allocable portion of the allowance for loan losses is considered to provide for such changes in estimated fair value. The fair value of nonaccrual loans has been estimated at their carrying amount because it is not practicable to reasonably assess the credit risk adjustment that would be applied in the marketplace for such loans. The fair value of commitments, which include standby letters of credit, is not material to the financial statements as a whole.

The fair value of junior subordinated debentures is estimated by discounting the cash flows through maturity based on prevailing rates offered on the five-year Treasury bond, plus the current market spread.

The fair value of passbook, NOW, and money market deposit accounts is considered to be equivalent to their withdrawable amount. The fair value of certificates of deposit and FHLB borrowings is estimated using the rates currently offered for deposits and borrowings of similar remaining maturities.

The fair value estimates presented are based on pertinent information available to management as of December 31, 2008 and 2007. Such amounts have not been comprehensively revalued for purposes of these financial statements since those dates, and therefore current estimates of fair value may differ significantly from the amounts presented above.

14. SUBSEQUENT EVENTS

In March 2009, FDIC issued a letter indicating that it intends to charge insured institutions a special assessment fee in 2009 that may be as much as 20 basis points of the Company's deposits or assessment base as of June 30, 2009, but the actual amount has not been determined by the FDIC. The Company expects to accrue and record this one-time expense when FDIC finalizes the assessment in the second quarter of 2009, and expects to pay the fee in the third quarter of 2009.

INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Stockholders of
Malaga Financial Corporation
Palos Verdes Estates, California

We have audited the accompanying consolidated balance sheets of Malaga Financial Corporation and subsidiary (the "Company") as of December 31, 2008 and 2007, and the related consolidated statements of operations, stockholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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, such consolidated financial statements present fairly, in all material respects, the financial position of the Company at December 31, 2008 and 2007, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

Los Angeles, California
April 23, 2009

BOARD OF DIRECTORS AND OFFICERS

BOARD OF DIRECTORS*

Robert E. Kershaw
Chairman of the Board

Steven P. L. Sheng
Corporate Secretary

Raymond L. Craemer, M.D.

Jerry A. Donahue

Leo K. C. Lee

Richard A. Oas, M.D.

CORPORATE ADMINISTRATION

Randy C. Bowers*
President and Chief Executive Officer

Jasna Penich*
Executive Vice President and
Chief Financial Officer

Susanne M. Chandler*
Senior Vice President and
Chief Risk Officer

Mel Hashimoto
Vice President and Controller

Gayle CdeBaca
Assistant Vice President and
Facilities Manager

RETAIL BANKING OPERATIONS

Aaron Aalcides
Senior Vice President
Branch Banking Executive

Connie Begovich
Assistant Vice President
Deposit Compliance / BSA Officer

Carmela Carroll
Assistant Vice President
Retail Banking Manager

Jocelyn Papadakis
Assistant Vice President
Project Manager / Security Officer

Rose Mary Callahan
Retail Banking Manager

Deanna Garcia
Retail Banking Manager

Lynne Neuman
Retail Banking Manager

LENDING OPERATIONS

Mark Bustamante
Senior Vice President and
Income Property Loan Officer

Russ Ciezata
Vice President and
Home Loan Specialist

Kenneth A. Johnson
Vice President and
Income Property Loan Officer

Dennis Mezzo
Vice President and
Residential Loan Production

Bonnie Shaw
Vice President and
Loan Operations Manager

John Turner
Vice President and
Private Banking Manager

Nina Brister
Assistant Vice President
Loan Service Manager

Cathy Jaramillo
Assistant Vice President and
Assistant Loan Operations Manager

*Directors or Officers of MFC and Malaga Bank.

MALAGA BANK CORPORATE OFFICE AND RETAIL LOCATIONS

CORPORATE HEADQUARTERS AND PALOS VERDES ESTATES OFFICE

2514 Via Tejon, Palos Verdes Estates, CA 90274
T 310-375-9000
F 310-373-3615

ROLLING HILLS ESTATES OFFICE

27450 Hawthorne Boulevard, Rolling Hills Estates, CA 90274
T 310-541-3000
F 310-544-5944

SAN PEDRO OFFICE

1460 West 25th Street, San Pedro, CA 90732
T 310-732-1100
F 310-831-7610

TORRANCE OFFICE (TEMPORARY OFFICE)

2927 Rolling Hills Road, Torrance, CA 90505
T 310-784-2000
F 310-784-0326

LOAN CENTER

23670 Hawthorne Blvd., Suite 101, Torrance, CA 90505
T 310-544-7800
F 310-544-0819

Call any Branch Office TOLL-FREE 888-8-MALAGA
Call the Loan Center TOLL-FREE 888-3-MALAGA
malagabank.com

MALAGA FINANCIAL CORPORATION

2514 Via Tejon, Palos Verdes Estates, CA 90274