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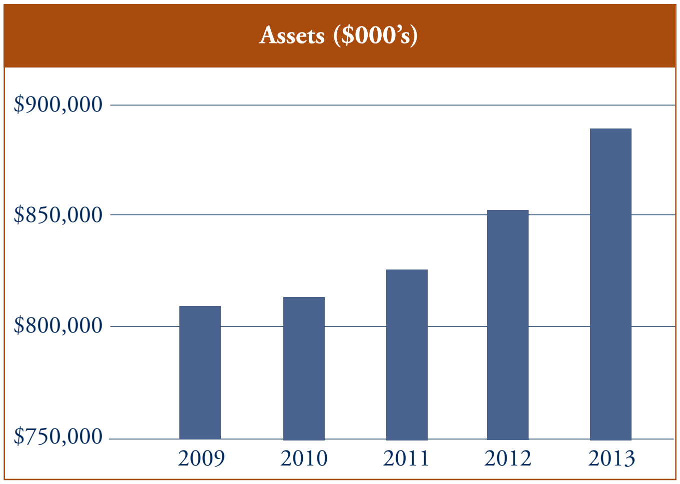
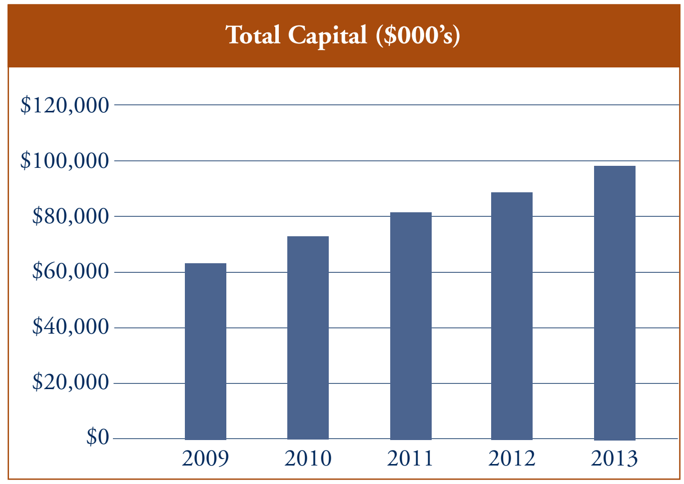
MALAGA
FINANCIAL CORPORATION

ANNUAL REPORT

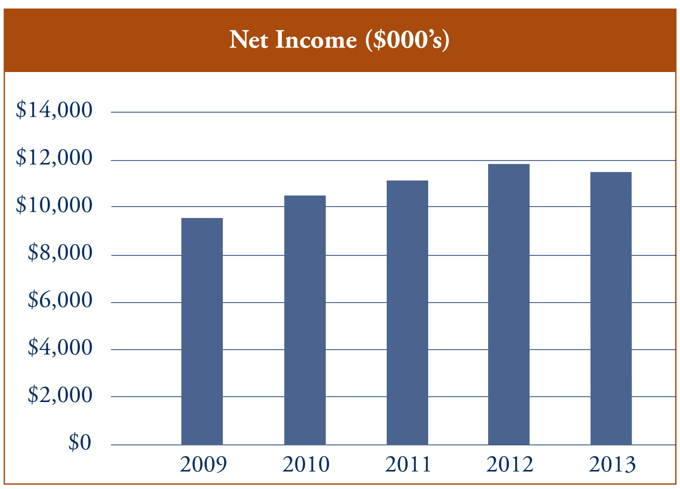
FINANCIAL STRENGTH

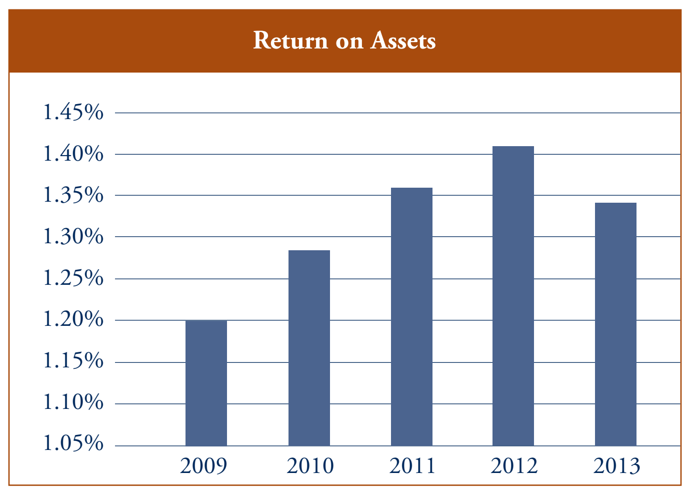
Consistently Strong and Stable Earnings





Eighth Consecutive Year of Capital and Asset Growth





2013 ACCOMPLISHMENTS

Consistently strong and stable earnings.

Malaga Bank received the BauerFinancial Inc. Five Star rating for the 25th consecutive quarter.*

Fourth quarter 2013, 17% dividend increase.

Quarterly dividends for the 37th consecutive quarter.

*Malaga Bank is a wholly owned subsidiary of Malaga Financial Corporation

DEAR SHAREHOLDERS AND FRIENDS,

We are pleased to report consistent strong and stable earnings for Malaga Financial Corporation and its subsidiary Malaga Bank. Net income for 2013 was $11.5 million, a decrease of $0.2 million over 2012, and earnings per share decreased from $1.98 per share in 2012 to $1.94 per share in 2013. Our strong annual net income resulted in a pre-tax return on average equity of 21.06% for the year.

Our loan portfolio increased from $779 million at December 31, 2012 to $822 million at the end of 2013. Our primary lending emphasis continued to be multifamily mortgage loans, which comprised 74% of our loan portfolio at December 31, 2013. We continue to originate conservatively underwritten loans which resulted in our having no foreclosures or delinquent loans at year-end.

Deposits grew by 5% to $634 million at year-end 2013 as our customer base continued to show a preference for our "community bank" level of personal service coupled with competitive products.

Capital levels continued to increase, with core capital and risk-based ratios at year-end 2013 of 13.36% and 23.10% respectively, substantially exceeding the minimum "well-capitalized" requirements of 5% and 10% respectively. In the fourth-quarter, Malaga Financial declared a quarterly cash dividend of 17.5 cents per share, payable in January 2014 and a special dividend of 10 cents per share payable in 2013. The quarterly dividend reflected a 17% increase in the quarterly dividend amount in effect for the past four quarters.

We continue to be recognized as one of the top performing thrifts in the United States as well as one of the safest depository institutions in our market place. As a result of our financial strength, we continue to support and partner with various community organizations, which further improve and strengthen the communities that we serve.

Many of the challenges we experienced in 2013 will continue to require our attention and efforts in 2014. The increasing time and expense required to address regulatory expectations continues to be an industry wide concern. Achieving our loan growth objective proved difficult in 2013 and we expect increasing competition for quality loans to continue throughout 2014. This will result in downward pressure on net interest margins and require continued discipline in maintaining our conservative underwriting standards. The uncertainty of the strength of the economic recovery and timing of interest rate increases will also require us to be vigilant. In spite of these issues we are confident that we will find solutions and continue to build on our past success.

On behalf of Malaga Financial Corporation and Malaga Bank, we thank our board of directors, management and staff for their contribution and commitment 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

Leo K. C. Lee
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, 2013, multi-family mortgage loans represented 74% of our loan portfolio and loans represented 93% of our total assets.

In 2013, our market area for deposits continued to be concentrated in the areas immediately surrounding our five branch offices in Palos Verdes Estates, Rolling Hills Estates, Torrance and San Pedro, California.

RESULTS OF OPERATIONS

Our net income was $11.5 million in 2013 compared to net income of $11.7 million in the previous year, a decrease of $194,000 or 2%. Earnings per share for 2013 were $1.94 (basic) and $1.93 (fully diluted), compared to $1.98 (basic) and $1.97 (fully diluted) in 2012.

Our return on average assets (ROA) was 1.34% in 2013 compared to 1.41% in 2012. Our return on average equity (ROE) was 12.25% in 2013 compared to 13.63% in 2012. The change in ROE is primarily the result of the increased level of stockholder equity which provides additional strength and safety to our balance sheet.

The following table sets forth selected financial data for the past five years:

	2013	2012	2011	2010	2009
Total assets (000's)	$ 886,852	$ 851,090	$ 827,234	$ 814,118	$ 810,850
Stockholders' equity (000's)	$ 97,079	$ 89,264	$ 80,835	$ 71,772	$ 62,998
Net income (000's)	$ 11,494	$ 11,689	$ 11,115	$ 10,494	$ 9,494
Basic earnings per share	$ 1.94	$ 1.98	$ 1.90	$ 1.80	$ 1.65
Diluted earnings per share	$ 1.93	$ 1.97	$ 1.89	$ 1.78	$ 1.64
ROA	1.34%	1.41%	1.36%	1.28%	1.20%
ROE	12.25%	13.63%	14.54%	15.58%	16.17%

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 on these assets and liabilities. The greater the excess of average interest-earning assets over average interest-bearing liabilities, the more beneficial the impact on net interest income.

Our net interest income decreased by $274,000 to $29.6 million in 2013 as a result of a decrease in the interest rate spread partially offset by a higher level of average interest-earning assets over average interest-bearing liabilities. 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) decreased from 3.55% in 2012 to 3.45% in 2013. The decrease in the interest rate spread was primarily attributable to a decrease in yield on average interest-earning assets of 0.42%, primarily from a decrease in loan portfolio yield. Partially offsetting this was a decrease of 0.32% in the average cost of funds. The decrease in the average cost of funds was due to a combination of maturity and repricing of certificates of deposit at lower rates and a higher mix of lower cost overnight Federal Home Loan Bank borrowings. Average interest-earning assets (principally loans) increased $31.6 million from 2012 and average interest-bearing liabilities increased $25.0 million for the same period.

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 rate spread, for the periods indicated:

WEIGHTED-AVERAGE BALANCES AND RATES

	2013		2012	
	(000's)		(000's)	
Loans receivable	$ 796,064	4.48 %	$ 788,642	4.90 %
Federal funds sold	30,142	0.23	4,012	0.24
Interest-bearing deposits in banks	3,029	0.85	1,894	1.04
FHLB stock	7,447	5.36	10,575	1.01
Total interest-earning assets	836,682	4.40	805,123	4.82
Deposits	623,340	0.37	560,635	0.46
FHLB borrowings	112,301	3.19	149,974	3.60
Senior subordinated notes	10,000	9.25	10,000	9.25
Junior subordinated debentures	13,404	2.59	13,404	2.79
Total interest-bearing liabilities	759,045	0.95	734,013	1.27
Excess of interest-earning assets over interest-bearing liabilities; interest rate spread	$ 77,637	3.45 %	$ 71,110	3.55 %

PROVISIONS FOR LOAN LOSSES

We recorded a provision for loan losses of $70,000 in 2013 versus a recovery of provision for loan losses of $211,000 in 2012. The increase in provision was primarily attributable to an increase in net loans (loan originations less amortizations and payoffs) of $42.7 million in 2013 versus a decrease of $13.4 million in 2012. There was one charge-off in 2013 for $4,000 and there were no delinquent loans as of December 31, 2013.

OTHER OPERATING INCOME

Other operating income increased $35,000 due primarily to higher fees from deposit 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. Operating expenses decreased $82,000 or 1% from $10.5 million in 2012 to $10.4 million in 2013. This decrease was due primarily to a $217,000 decrease in compensation, a decrease in general and administrative of $14,000 offset by an increase in office rent and utilities of $61,000, an increase in data processing of $45,000, an increase in professional services of $28,000 and a $13,000 increase in depreciation and amortization.

We employed 80 full-time equivalent employees at December 31, 2013, with an average of 5.1 years of service. 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 expressed as total overhead expenses as a percentage of net interest income and other operating income. Malaga Bank's efficiency ratios of 32.66% in 2013 and 32.71% in 2012 continued to be very favorable compared to the efficiency ratios of our peers, which averaged 77.07% in 2013 and 74.05% in 2012. Another measure of overhead efficiency is the percentage of overhead expense to average assets. Malaga Bank's ratio was 1.20% in 2013 versus 1.26% in 2012, which compared with a peer group average of 3.20% and 3.10% in 2013 and 2012, respectively. Malaga Bank had $10.8 million in average assets per employee at December 31, 2013 as compared to $10.0 million in average assets per employee at December 31, 2012.

FINANCIAL CONDITION

We continued to grow in 2013, as our total assets increased from $851.1 million at December 31, 2012 to $886.9 million at December 31, 2013.

LOAN PORTFOLIO

Total gross loans at December 31, 2013 were $822.0 million, up $42.7 million or 5% from the prior year-end. Our primary lending emphasis continued to be multi-family mortgage loans, which comprised 74% of our loan portfolio at December 31, 2013. The weighted-average rate of the loan portfolio was 4.48% at December 31, 2013 and 4.90% at December 31, 2012.

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 $2.9 million at December 31, 2013 and $2.8 million at December 31, 2012. We had no delinquent loans at year-end 2013 and 2012. Our allowance for loan losses to total loans outstanding was 0.35% at December 31, 2013 and 0.36% at December 31, 2012.

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 2013 continued to focus on attracting customer relationships at our branches. Total deposits increased by $30.7 million to $633.9 million at December 31, 2013. During the year non-interest bearing demand deposits increased $9.0 million to $77.1 million, lower cost money market and other accounts increased $40.3 million to $317.6 million and certificates of deposit decreased $18.6 million to $239.2 million. The increase in non-interest bearing deposits is primarily due to expansion of our branch system and increased focus on lower cost deposits. At December 31, 2013, we had outstanding certificates of deposit from the State of California totaling $48 million bearing interest at a weighted-average rate of 0.05%. Our weighted-average cost of deposits was 0.37% at December 31, 2013 compared to 0.46% at December 31, 2012.

FHLB BORROWINGS

Another major source of funding for us is advances from the Federal Home Loan Bank of San Francisco ("FHLB"). As of December 31, 2013, we had FHLB borrowings totaling $127.9 million as compared to $130.0 million at December 31, 2012. Our FHLB borrowings at December 31, 2013 had an average remaining maturity of 11 months and bore interest at a weighted-average rate of 2.25%. At that date, we had approximately $308 million of unused FHLB borrowing capacity.

SENIOR SUBORDINATED NOTES

As of December 31, 2013 and 2012, MFC had outstanding $10.0 million principal amount of Senior Subordinated Notes. These Notes bear interest at a rate of 9.25% per annum, payable quarterly, and are due and payable on the earlier to occur of December 31, 2016 or upon a change of control. All Notes were issued to directors and officers of MFC. The Notes are subordinated to all borrowings (other than the outstanding junior subordinated debentures) and may not be prepaid prior to maturity. MFC contributed the proceeds from the sale of these Notes to Malaga Bank in order to increase Malaga Bank's regulatory capital to provide a further cushion against any losses or reserves on Malaga Bank's loan portfolio in the recessionary economy at the time.

JUNIOR SUBORDINATED DEBENTURES

From time to time MFC has issued junior subordinated debentures related to issuance of trust-preferred securities by business trusts MFC has 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, 2013, MFC had $13.4 million junior subordinated debentures outstanding bearing interest at a weighted-average rate of 2.38% per annum. These debentures mature commencing in 2033.

STOCKHOLDERS' EQUITY AND REGULATORY CAPITAL

Our stockholders' equity grew by $7.8 million or 9% to $97.1 million at December 31, 2013, from $89.3 million at December 31, 2012. The increase was due principally to net income of $11.5 million and proceeds from the exercise of stock options of $478,000, net of $4.3 million of dividends to our stockholders.

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, 2013 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	13.36%	4.00%	5.00%
Tier 1 Risk-Based Capital to Risk-Weighted Assets	22.55%	N/A	6.00%
Total Risk-Based Capital to Risk-Weighted Assets	23.10%	8.00%	10.00%

STOCKHOLDERS AND STOCK INFORMATION

At December 31, 2013, MFC had 153 stockholders of record. Many of our stockholders purchased stock in connection with the organization of Malaga Bank. MFC's common stock is traded over-the-counter under the symbol MLGF.OB.

CONSOLIDATED BALANCE SHEETS

	December 31 2013	December 31 2012
ASSETS		
Cash and due from banks	**$ 13,426,332**	$ 13,732,186
Federal funds sold	**29,975,339**	36,153,904
Cash and cash equivalents	**43,401,671**	49,886,090
Interest-bearing deposits in banks	**4,786,000**	1,665,000
Loans receivable, net of allowance for loan loss of $2,866,400 (2013) and $2,761,900 (2012)	**823,799,442**	780,116,370
Accrued interest receivable	**2,630,436**	2,660,460
Building, office properties, and equipment—net	**5,411,279**	5,591,059
Investment in FHLB stock—at cost	**6,010,600**	9,102,200
Other assets	**812,810**	2,068,894
TOTAL	**$ 886,852,238**	$ 851,090,073
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES:		
Deposits:		
Noninterest-bearing	**$ 77,121,992**	$ 68,138,632
Interest-bearing	**556,782,260**	535,092,036
Total deposits	**633,904,252**	603,230,668
FHLB borrowings	**127,885,000**	130,000,000
Senior subordinated notes	**10,000,000**	10,000,000
Junior subordinated debentures	**13,404,000**	13,404,000
Accrued interest payable	**263,416**	274,485
Other liabilities	**2,271,978**	2,681,641
Deferred tax liability	**2,044,401**	2,235,513
Total liabilities	**789,773,047**	761,826,307
COMMITMENTS AND CONTINGENCIES (Note 4)		
STOCKHOLDERS' EQUITY:		
Common stock, $.001 par value—authorized, 20,000,000 shares; outstanding 5,967,699 shares (2013) and 5,921,902 shares (2012)	**5,968**	5,922
Additional paid-in capital	**15,712,559**	15,072,728
Retained earnings	**81,360,664**	74,185,116
Total stockholders' equity	**97,079,191**	89,263,766
TOTAL	**$ 886,852,238**	$ 851,090,073

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF OPERATIONS

	YEARS ENDED DECEMBER 31	
	2013	**2012**
INTEREST INCOME:		
Loans	**$ 36,326,315**	$ 39,081,085
Other investments	**495,152**	136,110
Total interest income	**36,821,467**	39,217,195
INTEREST EXPENSE:		
Deposits	**2,320,498**	2,593,456
Borrowings	**3,584,436**	5,404,591
Senior subordinated notes	**925,000**	927,534
Junior subordinated debentures	**347,738**	373,803
Total interest expense	**7,177,672**	9,299,384
NET INTEREST INCOME	**29,643,795**	29,917,811
PROVISION FOR (RECOVERY OF) LOAN LOSSES	**70,409**	(211,461)
NET INTEREST INCOME AFTER PROVISION FOR (RECOVERY OF) LOAN LOSSES	**29,573,386**	30,129,272
OTHER OPERATING INCOME	**627,034**	592,111
OTHER OPERATING EXPENSE:		
Compensation	**5,572,000**	5,788,697
Office rent and utilities	**989,268**	928,024
Professional services	**190,504**	162,558
Data processing	**869,754**	824,894
Deposit insurance premiums	**410,318**	406,231
Depreciation and amortization	**369,660**	357,383
General and administrative	**2,042,411**	2,058,346
Total other operating expense	**10,443,915**	10,526,133
INCOME BEFORE INCOME TAX EXPENSE	**19,756,505**	20,195,250
INCOME TAX EXPENSE	**8,262,198**	8,506,645
NET INCOME	**$ 11,494,307**	$ 11,688,605
BASIC EARNINGS PER SHARE	**$ 1.94**	$ 1.98
DILUTED EARNINGS PER SHARE	**$ 1.93**	$ 1.97

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012

	Common Stock				
	Number of Shares	Amount	Additional Paid-in Capital	Retained Earnings	Total Stockholders' Equity
BALANCE—January 1, 2012	5,889,996	$ 5,890	$ 14,633,420	$ 66,195,954	$ 80,835,264
Net income				11,688,605	11,688,605
Cash dividends declared				(3,699,443)	(3,699,443)
Stock options exercised	31,906	32	319,975		320,007
Stock options compensation expense			76,833		76,833
Excess tax benefit from exercise of stock options			42,500		42,500
BALANCE—December 31, 2012	5,921,902	5,922	15,072,728	74,185,116	89,263,766
Net income				11,494,307	11,494,307
Cash dividends declared				(4,318,759)	(4,318,759)
Stock options exercised	45,797	46	477,844		477,890
Stock options compensation expense			47,287		47,287
Excess tax benefit from exercise of stock options			114,700		114,700
BALANCE—December 31, 2013	5,967,699	$ 5,968	$ 15,712,559	$ 81,360,664	$ 97,079,191

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR YEARS ENDED DECEMBER 31	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	**$ 11,494,307**	$ 11,688,605
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of deferred loan fees—net of costs	**673,729**	797,536
Provision for (recovery of) loan losses	**70,409**	(211,461)
Excess tax benefit related to exercise of stock options	**(114,700)**	(42,500)
Depreciation and amortization	**369,660**	357,383
Net decrease in deferred income taxes	**(191,112)**	(294,750)
Stock option compensation expense	**47,287**	76,833
Net decrease in accrued interest receivable and other assets	**1,286,107**	619,145
Net increase (decrease) in accrued interest payable and other liabilities	**589,511**	(1,028,737)
Net cash provided by operating activities	**14,225,198**	11,962,054
CASH FLOWS FROM INVESTING ACTIVITIES:		
Net increase in interest-bearing deposits in banks	**(3,121,000)**	(527,000)
Net (increase) decrease in loans receivable	**(44,427,210)**	11,037,332
Purchase of FHLB stock	**(293,500)**	
Redemption of FHLB stock	**3,385,100**	2,584,100
Purchase of premises and equipment	**(189,880)**	(241,028)
Net cash provided by (used in) investing activities	**(44,646,490)**	12,853,404
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase in deposits	**30,673,584**	55,712,098
Proceeds from FHLB borrowings	**35,885,000**	32,000,000
Repayment of FHLB borrowings	**(38,000,000)**	(71,065,000)
Dividends paid	**(5,214,301)**	(3,552,780)
Proceeds from exercise of stock options	**477,890**	320,007
Excess tax benefit related to exercise of stock options	**114,700**	42,500
Net cash provided by financing activities	**23,936,873**	13,456,825
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	**(6,484,419)**	38,272,283
CASH AND CASH EQUIVALENTS—Beginning of year	**49,886,090**	11,613,807
CASH AND CASH EQUIVALENTS—End of year	**$ 43,401,671**	$ 49,886,090
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION Cash paid during the year for:		
Interest	**$ 7,188,741**	$ 9,811,523
Income taxes	**$ 7,974,000**	$ 8,865,000
SUPPLEMENTAL SCHEDULE OF NONCASH FINANCING ACTIVITIES		
Dividend payable		$ 895,543

See notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012

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"). MFC was formed in 2002 to operate as a holding company for the Bank. In 2003, MFC and the Bank completed a holding company reorganization in which MFC acquired all of the outstanding capital stock of the Bank and the shareholders of the Bank became shareholders of MFC. All intercompany balances and transactions have been eliminated in consolidation.

In June 2003, MFC issued $5,155,000 of junior subordinated debentures to PVP Statutory Trust I and in January 2005, MFC issued $2,578,000 of junior subordinated debentures to PVP Statutory Trust II and $5,671,000 of junior subordinated debentures to PVP Statutory Trust III, ("the Trusts"). The Company follows generally accepted accounting principles that determines when variable interest entities should be consolidated and determined that the Trusts should not be consolidated. As a result, the consolidated balance sheets include $13,404,000 as junior subordinated debentures. Also included in other assets in the consolidated balance sheet is $404,000 of investments in the Trusts, which is reported using the cost method.

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, California. The Company operates through six locations, five branches and one loan center, including its headquarters located in the city of Palos Verdes Estates, California.

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 ("GAAP") 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 and fair value determinations.

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 $6,826,000 and $5,869,000 at December 31, 2013 and 2012, respectively.

Interest-Bearing Deposits in Banks—Interest-bearing deposits in banks mature within one year and are 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. Premiums on loans are amortized to interest 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.

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, the loans' estimated market value 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 allowance is included in the allowance for loan losses. Impairment is measured on a loan-by-loan basis for multi-family, construction, and commercial loans. Large groups of smaller balance homogenous loans are collectively evaluated for impairment.

Loans are reported as restructured when the Bank grants a concession to a borrower experiencing financial difficulties that it would not otherwise consider. As a result of these concessions, restructured loans are impaired as the Bank will not collect all amounts due, both principal and interest, in accordance with the terms of the original loan agreement. Impairment reserves on non-collateral dependent restructured loans are measured by comparing the present value of expected future cash flows on the restructured loans discounted at the interest rate of the original loan agreement to the loan's carrying value. These impairment reserves are recognized as a specific component to be provided for in the allowance for loan losses.

Loan origination 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. 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. The allowance consists of specific, general, and unallocated components. The specific component relates to loans that are classified as impaired. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

Although management believes that the level of the allowance as of December 31, 2013, 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 loan losses, or charge-offs.

Building, Office Properties, and Equipment—Building, leasehold improvements, office properties, and equipment are carried at cost, less accumulated depreciation and amortization. The cost of the building is depreciated using the straight-line method over 39 years. Office properties 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.

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.

Federal Home Loan Bank (FHLB) 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. FHLB stock is carried at cost, classified as a restricted security, and both cash and stock dividends are reported as income when earned. An impairment analysis of FHLB stock is performed annually or when events or circumstances indicate possibility of impairment.

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 basis of assets and liabilities and their reported amounts in the financial statements. Under this method, deferred tax assets and liabilities are determined based on the differences between the financial statements and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. The effect of a change in tax rates for deferred tax assets and liabilities is recognized in income in the period that includes the enacted date.

The Company recognizes the tax benefit from uncertain tax positions only if it is more likely than not that the tax positions will be sustained on examination by the tax authorities, based on the technical merits of the position. The tax benefit is measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. The Company reviews and evaluates tax positions in its major jurisdictions and determines whether or not there are uncertain tax positions that require financial statement recognition. Based on this review, the Company has determined that no reserves for uncertain tax positions were required to have been recorded as a result of the adoption of such guidance for any of the Company's open tax years. The Company files income tax returns in the U.S. federal jurisdiction and in California. The Company is no longer subject to income tax examinations by taxing authorities for years before 2010 for its federal filings and 2009 for its California filings. The Company accounts for interest and penalties related to uncertain tax positions as part of its provision for federal and state.

Financial Instruments—In the ordinary course of business, the Company has entered into off-balance sheet agreements consisting of commitments to extend credit, commercial letters of credit, and standby letters of credit. Such financial instruments are recorded in the financial statements when they are funded or the related fees are incurred or received.

Common Stock—The Company has authorized 20 million shares of common stock. Each share entitles the holder to one vote. There are no dividend or liquidation preferences, participation rights, call prices or dates, conversion prices or rates, sinking fund requirements, or unusual voting rights associated with these shares.

Earnings Per Share (EPS)—Basic EPS is determined by dividing net income by the average number of shares of common stock outstanding, while diluted EPS is 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 $0.70 and $0.60 per share of common stock in 2013 and 2012, respectively.

Stock-Based Compensation—The Company accounts for stock-based compensation under Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 718-10, *Share-Based Payment*, for stock-based compensation. ASC 718-10 requires that compensation cost relating to share-based compensation transactions be recognized in the statements of operations based upon the grant-date fair value of the stock-based compensation granted by the Company. The effect of stock-based accounting rules are to require entities to measure the cost of director and employee services received in exchange for stock-based compensation and to recognize the cost over the period the director or employee is required to provide services for the award. The Company uses the Black-Scholes option-pricing model that meets the fair value objective within the ASC.

Comprehensive Income—Accounting principles require that recognized revenue, expenses, gains and losses be included in net income. Certain changes in shareholders' equity from non-owner sources, such as unrealized gains and losses on available-for-sale securities or defined benefit pension liability adjustments, among other items, are reported within comprehensive income and shown as a separate component of the equity section in the consolidated balance sheets. The Company does not have any other comprehensive income items and for the years ended December 31, 2013 and 2012, therefore, total comprehensive income equals net income.

Recent Accounting Pronouncements—In January 2013, the FASB issued ASU No. 2013-01, *Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities*. The Update clarifies that ASU. 2011-11 applies only to derivatives, including bifurcated embedded derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions that are either offset or subject to an enforceable master netting arrangement or similar agreement. Entities with other types of financial assets and financial liabilities subject to a master netting arrangement or similar agreement are no longer subject to the disclosure requirements in ASU. 2011-11. The amendments are effective for annual and interim reporting periods beginning on or after January 1, 2013. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

In February 2013, the FASB issued ASU No. 2013-02, *Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*. ASU No. 2013-02 requires an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component and to present either on the face of the statement where net income is presented, or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income, but only if the amount reclassified is required to be reclassified to net income in its entirety in the same reporting period. The amendments are effective for annual and interim reporting periods beginning on or after December 15, 2012. The adoption of ASU No. 2013-02 did not have a material impact on the Company's consolidated financial statements.

2. LOANS RECEIVABLE

Loans receivable as of December 31, 2013 and 2012, are summarized as follows:

Description	2013	2012
Residential mortgage loans–multi-family	**$ 603,328,920**	$ 550,810,183
Residential mortgage loans–single family	**168,864,168**	171,308,685
Commercial loans	**44,500,910**	47,306,228
Construction loans	**1,101,077**	6,309,614
Business banking loans	**3,830,912**	3,047,903
Consumer loans	**355,866**	469,243
	821,981,853	779,251,856
Less:		
Allowance for loan losses	**(2,866,400)**	(2,761,900)
Deferred loan costs–net of fees	**4,683,989**	3,626,414
	1,817,589	864,514
Total	**$ 823,799,442**	$ 780,116,370

For reporting purposes recorded investments for the Company approximates unpaid principal balance as the other components such as deferred fees/costs, premiums, discounts, accrued interest are not deemed material.

As of December 31, 2013 and 2012, loans with adjustable rates of interest (including loans with an initial fixed rate for 1 to 10 years that subsequently convert to adjustable rate) totaled $819.2 million and $776.9 million, respectively, and loans with fixed rates of interest totaled $3.4 million and $3.9 million, respectively. Adjustable-rate loans are generally indexed to the FHLB's Eleventh District Cost of Funds Index, 12-Month Constant Maturity Index, London InterBank Offered Rate (LIBOR), 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, 2013 and 2012, real estate loans aggregating $649.5 million and $628.8 million, respectively, were pledged as collateral against FHLB borrowings and real estate loans totaling $73.5 million and $69.9 million, respectively, were pledged to secure deposits held by the state of California. In addition, home equity lines of credit totaling $9.8 million and $11.9 million were pledged as collateral to the Federal Reserve Bank discount window at December 31, 2013 and 2012, respectively.

Activity in the allowance for loan losses and unfunded loan commitments for the years ended December 31, 2013 and 2012 is summarized as follows:

	2013	2012
Allowance for loan losses:		
Balance–beginning of year	**$ 2,761,900**	$ 2,880,920
Provision for (recovery of) loan losses	**100,209**	(192,461)
Recoveries (charge-offs), net	**4,291**	73,441
Balance–end of year	**$ 2,866,400**	$ 2,761,900
Reserve for unfunded loan commitments:		
Balance–beginning of year	**$ 83,800**	$ 102,800
(Recovery of) provision for losses on unfunded loan commitments	**(29,800)**	(19,000)
Balance–end of year	**$ 54,000**	$ 83,800

A breakdown of the allowance for loan losses as of December 31, 2013 and 2012, by loan type, is as follows:

	Multi-Family	Single Family	Commercial	Construction	Business Banking	Consumer	Total
Balance – December 31, 2011	$ 2,124,237	$ 580,823	$ 67,766	$ 95,012	$ 8,237	$ 4,845	**$ 2,880,920**
Total charge-offs	-	-	-	-	-	-	**-**
Total recoveries	-	-	64,200	-	-	9,241	**73,441**
Provision for (recovery of) loan losses	(229,376)	28,141	(86,193)	76,848	1,039	17,080	**(192,461)**
Balance – December 31, 2012	$ 1,894,861	$ 608,964	$ 45,773	$ 171,860	$ 9,276	$ 31,166	**$ 2,761,900**
Total charge-offs	-	-	-	-	(3,609)	-	(3,609)
Total recoveries	-	-	7,900	-	-	-	**7,900**
Provision for (recovery of) loan losses	308,022	(54,908)	(7,660)	(141,285)	4,800	(8,760)	**100,209**
Balance – December 31, 2013	$ 2,202,883	$ 554,056	$ 46,013	$ 30,575	$ 10,467	$ 22,406	**$ 2,866,400**

The reserve 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 reserves 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 were two loans in the amount of $1.6 million and one loan in the amount of $1.7 million considered to be impaired but accruing interest at December 31, 2013 and 2012, respectively. These loans also represent the Company's only troubled debt restructuring as of December 31, 2013 and 2012. There was no material difference between the pre-modification and post-modification balances on the loans restructured as troubled debt. These loans had a specific allowance of $3,600 and $7,900 at December 31, 2013 and 2012, respectively. A specific allowance of $7,900 was recovered in 2013. The average recorded investment in impaired loans during the years ended December 31, 2013 and 2012 was $1.6 million and $1.7 million, respectively. Interest income of $88,349 and $90,894 was recognized on impaired loans during the years ended December 31, 2013 and 2012, respectively, all of which was received in cash. There were no troubled debt restructuring that defaulted within twelve months of modification.

The Company manages asset quality and controls credit risk through diversification of the loan portfolio and the application of policies designed to promote sound underwriting and loan monitoring practices. The Company's senior management team is charged with monitoring asset quality, establishing credit policies and procedures and enforcing the consistent application of these policies and procedures across the Company. Reviews of non-performing, past due loans and larger credits, designed to identify potential charges to the allowance for loan losses, and to determine the adequacy of the allowance, are conducted on an ongoing basis. These reviews consider such risk factors as the financial strength of the borrowers, the value of the applicable collateral, loan loss experience, estimated loan losses, growth in the loan portfolio, prevailing economic conditions and other factors, which are collectively evaluated in order to determine if adjustments are necessary to the historical losses of each portfolio segment, the baseline for determining the allowance for loan losses.

The Company uses several credit quality indicators to manage credit risk in an ongoing manner. The Company's primary credit quality indicators are to use an internal credit risk rating system that categorizes loans into pass, special mention, or classified categories. Credit risk ratings are applied individually to all loans that have significant or unique credit characteristics that benefit from a case-by-case evaluation. The following are the definitions of the Company's credit quality indicators:

- Pass: Loans in all classes that comprise the commercial and consumer portfolio segments that are not adversely rated, are contractually current as to principal and interest, and are otherwise in compliance with the contractual terms of the loan agreement. Management believes that there is a low likelihood of loss related to those loans that are considered pass.
- 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 Company'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 repayment of the debt. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.
- Doubtful/Loss: Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or repayment in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The possibility of loss is extremely high, but because of certain important and reasonably specific pending factors, which may work towards strengthening of the asset, classification as a loss (and immediate charge off) is deferred until more exact status may be determined. In certain circumstances, a Doubtful rating will be temporary, while the Company is awaiting an updated collateral valuation. In these cases, once the collateral is valued and appropriate margin applied, the remaining un-collateralized portion will be charged off. The remaining balance, properly margined, may then be upgraded to Substandard, however, must remain on non-accrual. A loss rating is assigned to loans considered un-collectible and of such little value that the continuance as an active Company asset is not warranted. This rating does not mean that the loan has no recovery or salvage value, but rather that the loan should be charged off now, even though partial or full recovery may be possible in the future.

Loans with classification of pass, special mention, substandard, and doubtful as of December 31, 2013 and 2012, are summarized as follows:

December 31, 2013	Pass	Special Mention	Substandard	Doubtful	Total
Residential mortgage loans – multi-family	$ 602,491,569	$ -	$ 837,351	$ -	**$ 603,328,920**
Residential mortgage loans – single family	168,323,736	42,949	497,483	-	**168,864,168**
Commercial loans	41,407,226	-	3,093,684	-	**44,500,910**
Construction loans	1,101,077	-	-	-	**1,101,077**
Business banking loans	3,822,000	-	8,912	-	**3,830,912**
Consumer loans	355,866	-	-	-	**355,866**
Total	$ 817,501,474	$ 42,949	$ 4,437,430	$ -	**$ 821,981,853**

December 31, 2012	Pass	Special Mention	Substandard	Doubtful	Total
Residential mortgage loans – multi-family	$ 549,957,353	$ -	$ 852,830	$ -	**$ 550,810,183**
Residential mortgage loans – single family	171,261,935	46,750	-	-	**171,308,685**
Commercial loans	44,347,163	-	2,959,065	-	**47,306,228**
Construction loans	6,309,614	-	-	-	**6,309,614**
Business banking loans	3,047,903	-	-	-	**3,047,903**
Consumer loans	469,243	-	-	-	**469,243**
Total	$ 775,393,211	$ 46,750	$ 3,811,895	$ -	**$ 779,251,856**

There were no loans past due or on nonaccrual status as of December 31, 2013 and 2012. 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 $370,517 and $399,325 in 2013 and 2012, respectively.

A summary of related-party loan activity for the years ended December 31, 2013 and 2012 is as follows:

	2013	2012
Beginning balance	**$ 9,786,995**	$ 6,142,400
Credit granted–including renewals	**800,722**	4,334,742
Repayments	**(984,252)**	(690,147)
Ending balance	**$ 9,603,465**	$ 9,786,995

3. BUILDING, OFFICE PROPERTIES, AND EQUIPMENT

Building, office properties, and equipment as of December 31, 2013 and 2012, are summarized as follows:

Description	2013	2012
Land	**$ 1,275,364**	$ 1,275,364
Building	**3,553,211**	3,550,561
Leasehold improvements	**1,856,368**	1,868,840
Equipment	**1,515,595**	1,445,185
Furniture and fixtures	**679,237**	678,061
Construction in progress	**21,414**	1,650
	8,901,189	8,819,661
Accumulated depreciation and amortization	**(3,489,910)**	(3,228,602)
Total	**$ 5,411,279**	$ 5,591,059

Depreciation and amortization expense for the years ended December 31, 2013 and 2012 was $369,660 and $357,383, 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 $4.6 million and $4.9 million, undisbursed funds for construction loans of $624,000 and $1.6 million, and undrawn lines of credit previously granted of approximately $28.5 million and $27.0 million at December 31, 2013 and 2012, 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 subject to indemnification claims and no liabilities have been recorded for these obligations on the balance sheet as of December 31, 2013 and 2012.

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 $436,000 and $452,000 at December 31, 2013 and 2012, respectively.

Leases—The Company leases office premises under operating leases that expire at various dates through September 24, 2022. Rental expense was $647,135 and $613,686 for the years ended December 31, 2013 and 2012, respectively. The projected minimum rental payments under the terms of the leases as of December 31, 2013, are as follows:

Years Ending December 31	
2014	$ 656,904
2015	656,904
2016	656,904
2017	656,904
2018	656,904
Thereafter	985,246
Total	$ 4,269,766

5. DEPOSITS

Deposit balances and the weighted-average interest rates for each category of deposits as of December 31, 2013 and 2012, are summarized as follows:

	2013		**2012**	
	Interest Rate	**Amount**	**Interest Rate**	**Amount**
Demand deposits	**0.00%**	**$ 77,121,992**	0.00%	$ 68,138,632
NOW accounts	**0.19**	**61,906,276**	0.19	65,012,731
Passbooks	**0.24**	**31,036,240**	0.23	26,954,095
Money market accounts	**0.39**	**224,687,889**	0.39	185,341,635
Certificates of deposit– non jumbo	**0.51**	**63,891,913**	0.60	70,884,918
Certificates of deposit– jumbo	**0.52**	**175,259,942**	0.61	186,898,657
Total	**0.36%**	**$ 633,904,252**	0.41%	$ 603,230,668

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

Certificates of deposit maturities at December 31, 2013, are summarized as follows:

Years Ending December 31	
2014	$ 211,911,348
2015	13,395,413
2016	9,877,993
2017	1,358,607
2018	2,608,494
Total	$ 239,151,855

As of December 31, 2013 and 2012, the Company had certificates of deposit from the state of California Treasurer's Office of $48 million.

In the ordinary course of business and as part of its normal banking activities, the Company has received deposits from certain directors, major shareholders and officers as well as entities with which these individuals are associated. These related parties had deposits at the Company of $3,851,531 and $2,616,031, at December 31, 2013 and 2012, respectively. Management believes these transactions were made on substantially the same terms, conditions, and prevailing interest rates, as comparable transactions with other customers.

6. FHLB BORROWINGS

A primary additional funding source for the Company is a credit line with the FHLB of San Francisco of up to 50% of the Company's total assets. Interest is payable monthly at a weighted-average rate of 2.25% as of December 31, 2013. The FHLB borrowings are collateralized by real estate loans (see Note 2) and the capital stock of the FHLB owned by the Company.

Maturities of FHLB borrowings as of December 31, 2013, are summarized as follows:

Years Ending December 31	
2014	$ 81,885,000
2015	23,000,000
2016	18,000,000
2017	5,000,000
Total	$ 127,885,000

7. SENIOR SUBORDINATED NOTES

In December 2009 and January 2010, in order to obtain funds to increase the regulatory capital of the Bank, MFC issued $10,000,000 of 9.25% senior subordinated notes, the proceeds of which were contributed to the Bank as capital. The notes are due on the earlier to occur of December 31, 2016, or upon a change of control; are subordinated to all borrowings of MFC (other than the outstanding junior subordinated debentures); and may not be prepaid prior to maturity. All notes were issued to directors and an executive officer of MFC.

8. 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. PVP Statutory Trust I, II and III were formed by the Company for the sole purpose of issuing trust preferred securities. For financial reporting purposes, the Trusts are not consolidated and the junior subordinated debentures held by the Trusts, issued and guaranteed by the Company, are reflected within the Company's consolidated balance sheets. 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.

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 3.35% per annum at December 31, 2013.

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, have been redeemable at par at MFC's option since 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 2.01% per annum at December 31, 2013.

In January 2005, MFC 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, have been redeemable at par at MFC's option since March 2010, and require quarterly distributions/interest payments at a fixed rate of 5.67% through 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 2.01% per annum at December 31, 2013.

9. INCOME TAXES

A summary of income tax expense (benefit) for the years ended December 31, 2013 and 2012 is as follows:

	2013	2012
Current:		
State	**$ 2,206,587**	$ 2,202,759
Federal	**6,246,723**	6,598,636
Total Current	**8,453,310**	8,801,395
Deferred:		
State	**(67,519)**	(31,209)
Federal	**(123,593)**	(263,541)
Total Deferred	**(191,112)**	(294,750)
Total	**$ 8,262,198**	$ 8,506,645

The components of the net deferred liability as of December 31, 2013 and 2012 are as follows:

	2013	2012
FEDERAL		
Deferred tax liabilities:		
Loan fees/costs	**$ (2,657,554)**	$ (2,433,840)
FHLB dividends	**(673,475)**	(1,113,555)
Depreciation	**(106,967)**	(96,270)
Other	**(64,444)**	(64,188)
Gross deferred tax liability	**(3,502,440)**	(3,707,853)
Deferred tax assets:		
California franchise tax	**989,107**	1,011,399
Bad debt and loan loss deduction	**1,023,403**	998,760
Other	**111,778**	195,949
Gross deferred tax asset	**2,124,288**	2,206,108
Net deferred tax liability	**$ (1,378,152)**	$ (1,501,745)

	2013	2012
STATE		
Deferred tax liabilities:		
Loan fees/costs	**$ (823,082)**	$ (753,795)
FHLB dividends	**(208,584)**	(344,883)
Other	**(19,959)**	(19,880)
Gross deferred tax liability	**(1,051,625)**	(1,118,558)
Deferred tax assets:		
Depreciation	**33,795**	37,868
Bad debt and loan loss deduction	**316,962**	309,330
Other	**34,619**	37,592
Gross deferred tax asset	**385,376**	384,790
Net deferred tax liability	**$ (666,249)**	$ (733,768)

A reconciliation of total income tax expense for 2013 and 2012 to the expected tax expense computed by applying the statutory corporate income tax rate to pretax income for the years ended December 31, 2013 and 2012 is as follows:

	2013		2012	
	Amount	Percent	Amount	Percent
Tax expense at statutory rates	**$ 6,914,778**	**35%**	$ 7,068,338	35%
State franchise tax– net of federal benefit	**1,390,394**	**7**	1,411,508	7
Other	**(42,974)**		26,799	
Total	**$ 8,262,198**	**42%**	$ 8,506,645	42%

10. 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 consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of its 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 total assets (as defined). As of December 31, 2013 and 2012, the Bank met all applicable regulatory capital requirements.

As of December 31, 2013 and 2012, the most recent notification from the Office of the Comptroller of the Currency 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. The Company's and Bank's capital amounts and ratios are substantially the same.

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

	Actual		For Capital Adequacy Purposes		Applicable Federal Regulatory Requirements To Be Categorized As Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
As of December 31, 2013:						
Total capital to risk-weighted assets:	$ 121,209,656	23.10%	$ 41,983,172	8.00%	$ 52,478,965	10.00%
Core capital to adjusted tangible assets:	118,343,257	13.36	35,441,124	4.00	44,301,405	5.00
Tangible capital to adjusted tangible assets:	118,343,257	13.36	13,290,421	1.50	N/A	N/A
Tier 1 capital to risk-weighted assets:	118,343,257	22.55	N/A	N/A	31,487,379	6.00
As of December 31, 2012:						
Total capital to risk-weighted assets:	$ 113,757,628	22.82%	$ 39,885,111	8.00%	$ 49,856,388	10.00%
Core capital to adjusted tangible assets:	110,995,728	13.05	34,010,093	4.00	42,512,616	5.00
Tangible capital to adjusted tangible assets:	110,995,728	13.05	12,753,785	1.50	N/A	N/A
Tier 1 capital to risk-weighted assets:	110,995,728	22.26	N/A	N/A	29,913,833	6.00

11. STOCK OPTION PLANS

MFC has 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 MFC 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 than the fair market value of the common stock on the date of grant and the term of any option may not exceed 10 years. The 2003 Stock Option Plan expires on December 31, 2017.

Under the 2007 Director Plan, MFC may issue up to 600,000 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 ASC Topic 718, *Stock Compensation*, stock-based compensation expense was $47,287 and $76,833 for 2013 and 2012, respectively, which decreased the year's income before taxes by such amount and its effect on basic and diluted EPS was negligible. Cash provided by operating activities decreased by $114,700 and $42,500 for 2013 and 2012, respectively, and cash provided by financing activities increased by identical amounts for both 2013 and 2012 related to excess tax benefits from stock-based arrangements.

The status of shares subject to options and exercise prices during the year ended December 31, 2013, is as follows:

	Number of Options	Weighted-Average Exercise Price	Weighted-Average Term (Years)	Aggregate Intrinsic Value
Outstanding—beginning of year	248,225	$ 12.63		
Granted	46,000	16.82		
Exercised	(45,797)	10.43		
Canceled	(9,713)	9.79		
Outstanding—end of year	238,715	$ 13.98	2.49 years	$ 1,105,383
Vested and expected to vest—year-end	192,715	$ 13.30	2.13 years	$ 1,105,383
Exercisable—year-end	192,715	$ 13.30	2.13 years	$ 1,105,383
Shares available	605,000			

The status of shares subject to options and exercise price during the year ended December 31, 2012, is as follows:

	Number of Options	Weighted-Average Exercise Price	Weighted-Average Term (Years)	Aggregate Intrinsic Value
Outstanding—beginning of year	244,095	$ 12.22		
Granted	46,000	12.54		
Exercised	(31,906)	10.03		
Canceled	(9,964)	10.52		
Outstanding—end of year	248,225	$ 12.63	2.58 years	$ 800,989
Vested and expected to vest—year-end	195,992	$ 12.55	2.08 years	$ 800,989
Exercisable—year-end	195,992	$ 12.55	2.08 years	$ 800,989
Shares available	641,288			

Information pertaining to options outstanding as of December 31, 2013, is as follows:

Range of Exercise Prices	Number Outstanding	Weighted-Average Remaining Contractual Life (Years)	Weighted-Average Exercise Price	Number Exercisable	Weighted-Average Exercise Price
$10.00 – $13.99	127,715	1.48	$ 12.10	127,715	$ 12.10
$14.00 – $16.82	111,000	3.66	16.14	65,000	15.66
Total	238,715	2.49	$ 13.98	192,715	$ 13.30

Certain information regarding options for the years ended December 31, 2013 and 2012 is as follows:

	2013	2012
Weighted-average fair value of stock options granted during the year	$ 0.67	$ 1.05
Total intrinsic value of options exercised	401,412	216,014
Total fair value of shares vested	68,060	104,400

As of December 31, 2013 and 2012, total unrecognized compensation costs related to options was $0 and approximately $16,000 (which was recorded as compensation expense in 2013), respectively.

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:

	2013	2012
Expected life (1)	1 year	1 year
Expected volatility (2)	14.19%	25.23%
Expected dividend yield (3)	3.57	3.39
Risk-free interest rate (4)	0.16	0.11

(1) The expected life 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.

12. EARNINGS PER SHARE (EPS)

A reconciliation of the numerator and denominator of the basic and diluted EPS computation for the years ended December 31, 2013 and 2012 is as follows. For the years ended December 31, 2013 and 2012, the dilutive effect of all options outstanding are included in the determination of diluted EPS since there were no options outstanding with an exercise price which exceeded the average market price of the Company's common stock for those years.

	2013			2012		
	Income (Numerator)	Shares (Denominator)	Per-Share Amount	Income (Numerator)	Shares (Denominator)	Per-Share Amount
Basic EPS						
Income available to common stockholders	$ 11,494,307	5,934,501	$ 1.94	$ 11,688,605	5,909,725	$ 1.98
Effect of Dilutive Securities						
Options–common stock equivalents		35,864	(0.01)		40,019	(0.01)
Diluted EPS						
Income available to common stockholders, plus assumed conversion	$ 11,494,307	5,970,365	$ 1.93	$ 11,688,605	5,949,744	$ 1.97

13. ESTIMATED FAIR VALUE INFORMATION

ASC Topic 820 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 nonrecurring basis.

As defined in ASC Topic 820, 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

There was one commercial loan considered to be impaired and measured and reported at fair value, on a nonrecurring basis (using Level 3 inputs), with an estimated fair value of $8,000 at December 31, 2013. There was also one loan with an estimated fair value of $1.7 million at December 31, 2012. Total losses related to this impaired loan were immaterial during the years ended December 31, 2013 and 2012.

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 as of December 31, 2013 and 2012:

2013

			Fair Value Measurement Using		
	Carrying Amount	**Estimated Fair Value**	**Level 1**	**Level 2**	**Level 3**
Assets:					
Cash and cash equivalents	$ 43,402,000	$ 43,402,000	$ 43,402,000	$	$
Interest-bearing deposits in banks	4,786,000	4,786,000	4,786,000		
Loans receivable	823,799,000	867,924,000			867,924,000
Accrued interest receivable	2,630,000	2,630,000	2,630,000		
Investment in FHLB stock	6,011,000	6,011,000		6,011,000	
Liabilities:					
Deposits	633,904,000	634,420,000		634,420,000	
FHLB borrowings	127,885,000	132,317,000		132,317,000	
Senior subordinated notes	10,000,000	10,647,000		10,647,000	
Junior subordinated debentures	13,404,000	8,186,000		8,186,000	
Accrued interest payable	263,000	263,000	263,000		

2012

	Carrying Amount	Estimated Fair Value	Fair Value Measurement Using Level 1	Level 2	Level 3
Assets:					
Cash and cash equivalents	$ 49,886,000	$ 48,886,000	$ 48,886,000	$	$
Interest-bearing deposits in banks	1,665,000	1,665,000	1,665,000		
Loans receivable	780,116,000	831,309,000			831,309,000
Accrued interest receivable	2,660,000	2,660,000	2,660,000		
Investment in FHLB stock	9,102,000	9,102,000		9,102,000	
Liabilities:					
Deposits	603,231,000	603,908,000		603,908,000	
FHLB borrowings	130,000,000	137,473,000		137,473,000	
Senior subordinated notes	10,000,000	10,882,000		10,882,000	
Junior subordinated debentures	13,404,000	8,390,000		8,390,000	
Accrued interest payable	274,000	274,000	274,000		

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 senior subordinated notes is estimated by discounting the cash flows through maturity based on the prevailing rates offered on the three-year and four-year Treasury bond as of December 31, 2013 and 2012, respectively, plus a predetermined margin calculated based on the Treasury bond rate with the same maturity as the note compared with the note's rate at the time of issuance.

The fair value of junior subordinated debentures is estimated by discounting the remaining contractual cash flows using the estimated current rate at which similar junior subordinated debentures have been issued.

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, 2013 and 2012. 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

The Company has evaluated subsequent events through March 14, 2014, which is the date the consolidated financial statements were available to be issued. There were no subsequent events that required disclosure in the consolidated financial statements.

REPORT OF INDEPENDENT AUDITORS

The Board of Directors and Shareholders of
Malaga Financial Corporation
Palos Verdes Estates, California

Report on Financial Statements

We have audited the accompanying consolidated financial statements of Malaga Financial Corporation and its subsidiary (the "Company"), which comprise the consolidated balance sheet as of December 31, 2013 and 2012, and the related consolidated statements of income, stockholders' equity and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

We believe that the audit evidence obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Malaga Financial Corporation and its subsidiary as of December 31, 2013 and 2012, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Moss Adams LLP

Los Angeles, California
March 14, 2014

BOARD OF DIRECTORS AND OFFICERS

BOARD OF DIRECTORS

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Richard A. Oas, M.D.*
Corporate Secretary

Raymond L. Craemer, M.D.*

Jerry A. Donahue*

Steven P. L. Sheng*

Doug Wible

CORPORATE ADMINISTRATION

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President/Chief Executive Officer

Jasna Penich*
Executive Vice President
Chief Financial Officer

Mel Hashimoto
Vice President
Controller

Gayle CdeBaca
Assistant Vice President
Facilities Manager

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Deposit Compliance/BSA Officer

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Retail Banking Manager

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Operations Administrator

Naher Elramly
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Branch Services Manager

Kristina Keys
Assistant Vice President
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Income Property Loan Officer

Mark Smith
Senior Vice President
Business Banking

Nina Brister
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Loan Service/Funding Manager

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Income Property Lending

Cathy Jaramillo
Vice President
Loan Processing Manager

Dennis Mezzo
Vice President
Loan Production Manager

*Directors or Officers of MFC and Malaga Bank.

MALAGA BANK CORPORATE OFFICE AND RETAIL LOCATIONS

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ROLLING HILLS ESTATES OFFICE

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SAN PEDRO OFFICE

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F 310-831-7610

LOAN CENTER

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

Call any Branch Office TOLL-FREE 888-8-MALAGA. Call the Loan Center TOLL-FREE 888-3-MALAGA
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MALAGA FINANCIAL CORPORATION

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