2015

MALAGA

FINANCIAL CORPORATION

ANNUAL REPORT

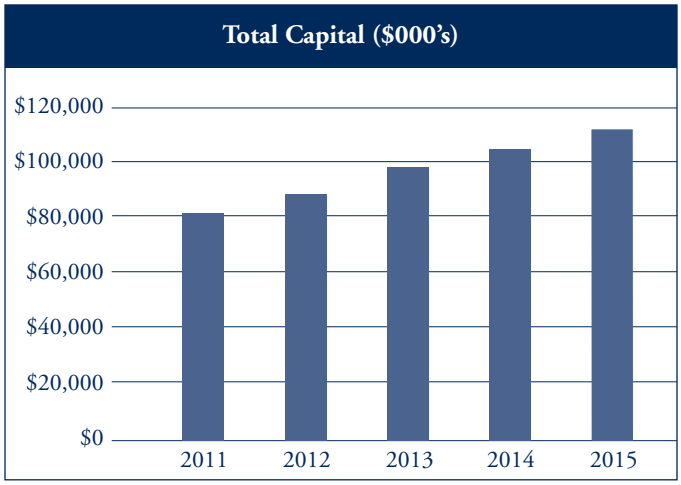
Celebrating 30 years as your community bank

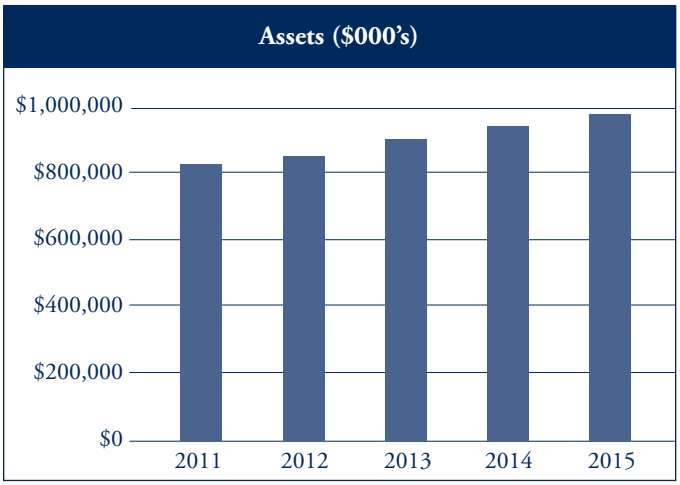
1985 MALAGA BANK 2015

We wish to express our thanks for the opportunity to serve the residents and businesses of Palos Verdes and the surrounding communities for the last thirty years. We look forward to continuing to be your local community bank of choice in the years to come.

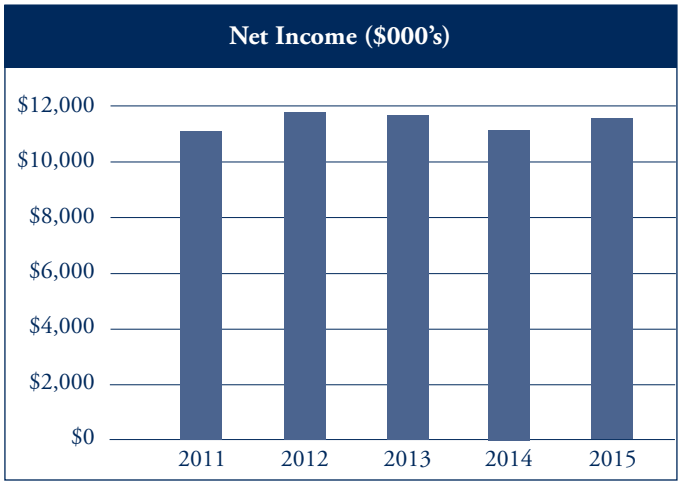
FINANCIAL STRENGTH

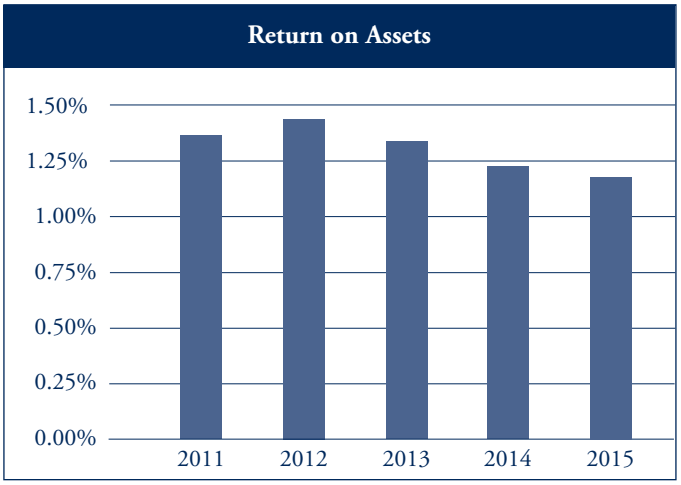
Ninth Consecutive Year of Capital and Asset Growth





Consistantly Strong and Stable Earnings





2015 ACCOMPLISHMENTS

Consistently strong and stable earnings.

Malaga Bank received the BauerFinancial Inc. Five Star rating for the 33rd consecutive quarter.*

Fourth quarter 2015, 13% dividend increase.

Quarterly dividends for the 44th consecutive quarter.

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

DEAR SHAREHOLDERS AND FRIENDS,

We are pleased to report that 2015 was another successful year for Malaga Financial Corporation and its subsidiary, Malaga Bank. We were delighted to celebrate our 30th anniversary during 2015 with sustained growth and profitability while continuing to provide a safe and friendly place to bank for our customers, shareholders and communities. The year presented a challenging operating environment for banks with ever-increasing regulatory expectations, uncertain financial markets, and a modest economic recovery. In addition, the pace of future interest rate increases proved highly unpredictable with much speculation about actions to be taken by the Federal Reserve and other central banks. In spite of these factors, we achieved the following results:

- Book value per share increased 5.6% from $17.29 to $18.26
- Earnings per share of $1.88 (basic) and $1.87 (fully diluted)
- Net Income of $11.4 million
- Return on pre-tax average equity (ROE) was 18.20%
- Return on average equity (ROE) was 10.55%
- Return on average assets (ROA) was 1.16%
- Assets increased by $37.1 million or 3.9% to $984.4 million
- No delinquent loans or non-performing assets/foreclosures at year-end

Our stock produced increased value to our shareholders with an increase in MLGF stock price to $22.01 as of December 31, 2015, in addition to paying dividends totaling 90¢ per share, including a special year-end dividend of 10¢ per share. Capital levels continued to increase to 13.20% core capital ratio and 25.31% risk-based ratio at year-end 2015, substantially exceeding the minimum "well-capitalized" requirements of 5% and 10% respectively.

Total gross loans at December 31, 2015 were $888.5 million, up $15.2 million or 2% from prior year-end, yet still short of our growth objectives. Loan production continued to be difficult in 2015 with increased competition as a result of relaxed underwriting standards, aggressive pricing, and new entrants into the market. We chose to adhere to our past discipline placing our emphasis on safe, conservative underwriting over growth.

Industry recognition of Malaga Financial and Malaga Bank's strong performance continued with our 6th consecutive year ranked in the top 3 institutions among the 100 largest publicly traded thrifts by SNL Financial.

As a community partner for the last 30 years, Malaga Bank is often recognized for its strong community support. We appreciate that we are seen as setting the standard on the Peninsula for what it means to be a strong, engaged corporate citizen. Malaga Bank's corporate culture encourages active, hands-on volunteer work in various nonprofit organizations throughout our communities. This dynamic community support further improves and strengthens our communities and can only be achieved as a result of our strong financial condition and earnings.

2016 will undoubtedly hold its own set of challenges and obstacles to overcome, but we are optimistic about our future.

On behalf of Malaga Financial Corporation and Malaga Bank, we thank all of you who contribute to our continued success; our board of directors, management and staff for their commitment and contributions to our day to day success, and you, our shareholders, for your loyalty, your business, and your investment.

Randy C. Bowers
President and
Chief Executive Officer

Jerry Donahue
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, 2015, multifamily mortgage loans represented 76% of our loan portfolio and loans represented 90% of our total assets.

In 2015, 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 $11.4 million in 2015 compared to net income of $11.2 million in the previous year, an increase of $195,000 or 2%. Earnings per share for 2015 were $1.88 (basic) and $1.87 (fully diluted), compared to $1.87 (basic) and $1.86 (fully diluted) in 2014.

Our return on average assets (ROA) was 1.16% in 2015 compared to 1.22% in 2014. Our return on average equity (ROE) was 10.55% in 2015 compared to 11.07% in 2014. The change in ROE is primarily the result of the increased level of stockholders' equity which provides additional strength and safety to our balance sheet.

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

	2015	2014	2013	2012	2011
Total assets (000's)	$ 984,382	$ 947,282	$ 886,852	$ 851,090	$ 827,234
Stockholders' equity (000's)	$ 111,007	$ 104,225	$ 97,079	$ 89,264	$ 80,835
Net income (000's)	$ 11,406	$ 11,211	$ 11,494	$ 11,689	$ 11,115
Basic earnings per share	$ 1.88	$ 1.87	$ 1.94	$ 1.98	$ 1.90
Diluted earnings per share	$ 1.87	$ 1.86	$ 1.93	$ 1.97	$ 1.89
ROA	1.16%	1.22%	1.34%	1.41%	1.36%
ROE	10.55%	11.07%	12.25%	13.63%	14.54%

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 increased by $643,000 to $30.3 million in 2015 as a result of a higher level of average interest-earning assets over average interest-bearing liabilities offset by a decrease in the interest rate spread. 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 3.23% in 2014 to 3.06% in 2015. The decrease in the interest rate spread was primarily attributable to a decrease in yield on average interest-earning assets of 0.20%, principally due to a decrease in loan portfolio yield resulting from an overall decrease in interest rates. Partially offsetting this was a decrease of 0.03% in the average cost of funds as we shifted a greater percentage of our interest bearing liabilities from higher cost FHLB borrowings to lower cost demand and money market deposits. Average interest-earning assets increased $67.6 million from 2014 and average interest-bearing liabilities increased $61.2 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

	2015		2014	
	(000's)		(000's)	
Loans receivable	$ 880,303	4.10%	$ 847,987	4.20%
Federal funds sold	66,509	0.26	34,303	0.25
Interest-bearing deposits in banks	13,504	0.50	10,076	0.51
FHLB stock	6,160	12.04	6,539	7.29
Total interest-earning assets	966,476	3.83	898,905	4.03
Deposits	752,246	0.33	668,422	0.36
FHLB borrowings	94,799	3.09	117,408	2.38
Senior subordinated notes	10,000	9.25	10,000	9.25
Junior subordinated debentures	13,404	2.61	13,404	2.55
Total interest-bearing liabilities	870,449	0.77	809,234	0.80
Excess of interest-earning assets over interest-bearing liabilities; interest rate spread	$ 96,027	3.06%	$ 89,671	3.23%

PROVISIONS FOR LOAN LOSSES

We recorded a provision for loan losses of $38,000 in 2015 versus $90,000 in 2014. The decrease in provision was primarily attributable to a decrease in the growth of the loan portfolio (loan originations less amortizations and payoffs) of $15.2 million in 2015 versus an increase of $48.3 million in 2014. There were no charge-offs in 2015 and no delinquent loans as of December 31, 2015.

OTHER OPERATING INCOME

Other operating income, which consists primarily of deposit related fees, decreased $4,000 from 2014 to 2015.

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 increased $360,000 or 3% from $10.9 million in 2014 to $11.2 million in 2015. This increase was due primarily to a $286,000 increase in compensation, a $2,000 increase in office rent and utilities, a $35,000 increase in deposit insurance premiums and a $120,000 increase in general and administrative offset by a $50,000 decrease in professional services, a $5,000 decrease in data processing and a $28,000 decrease in depreciation and amortization.

We employed 77 full-time equivalent employees at December 31, 2015, with an average of 6.1 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 34.36% in 2015 and 33.98% in 2014 continued to be very favorable compared to the efficiency ratios of our peers, which averaged 66.43% in 2015 and 76.31% in 2014. Another measure of overhead efficiency is the percentage of overhead expense to average assets. Malaga Bank's ratio was 1.13% in 2015 versus 1.17% in 2014, which compared with a peer group average of 2.77% and 3.09% in 2015 and 2014, respectively. Malaga Bank had $12.7 million in average assets per employee at December 31, 2015 as compared to $11.7 million in average assets per employee at December 31, 2014.

FINANCIAL CONDITION

We continued to grow in 2015, as our total assets increased from $947.2 million at December 31, 2014 to $984.4 million at December 31, 2015.

LOAN PORTFOLIO

Total gross loans at December 31, 2015 were $885.5 million, up $15.2 million or 2% from the prior year-end. Our primary lending emphasis continued to be multi-family mortgage loans, which comprised 76% of our loan portfolio at December 31, 2015. The weighted-average rate of the loan portfolio was 4.01% at December 31, 2015 and 4.13% at December 31, 2014.

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 $3.0 million at December 31, 2015 and December 31, 2014. We had no delinquent loans at year-end 2015 and 2014. Our allowance for loan losses to total loans outstanding was 0.34% at December 31, 2015 and 0.35% at December 31, 2014.

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 2015 continued to focus on attracting customer relationships at our branches. Total deposits increased by $48.2 million to $756.9 million at December 31, 2015. During the year, non-interest bearing demand deposits increased $11.1 million to $97.7 million, lower cost money market and other accounts increased $61.3 million to $400.6 million and certificates of deposit decreased $24.2 million to $258.6 million. The increase in non-interest bearing deposits is primarily due to an increased focus on lower cost deposits. At December 31, 2015, we had outstanding certificates of deposit from the State of California totaling $82 million bearing interest at a weighted-average rate of 0.07%. Our weighted-average cost of deposits was 0.28% at December 31, 2015 and 0.36% at December 31, 2014.

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, 2015, we had FHLB borrowings totaling $88.0 million as compared to $104.9 million at December 31, 2014. Our FHLB borrowings at December 31, 2015 had an average remaining maturity of 45 months and bore interest at a weighted-average rate of 2.69%. At that date, we had approximately $392 million of unused FHLB borrowing capacity.

SENIOR SUBORDINATED NOTES

As of December 31, 2015 and 2014, 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, 2015, MFC had $13.4 million junior subordinated debentures outstanding bearing interest at a weighted-average rate of 2.83% per annum. These debentures mature commencing in 2033.

STOCKHOLDERS' EQUITY AND REGULATORY CAPITAL

Our stockholders' equity grew by $6.8 million or 7% to $111.0 million at December 31, 2015, from $104.2 million at December 31, 2014. The increase was due principally to net income of $11.4 million and proceeds from the exercise of stock options of $720,000, net of $5.6 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, 2015 to those required by regulatory agencies for capital adequacy and well capitalized classification purposes:

	Malaga Bank	Minimum Capital Requirements	Well Capitalized Requirements
Tier 1 Capital to Average Assets	13.20%	4.00%	5.00%
Total Capital to Risk-Weighted Assets	25.32%	8.00%	10.00%
Common Tier 1 Capital to Risk-Weighted Assets	24.75%	4.50%	6.50%
Tier 1 Capital to Risk-Weighted Assets	24.75%	6.00%	8.00%

STOCKHOLDERS AND STOCK INFORMATION

At December 31, 2015, MFC had 155 stockholders of record. Many of our stockholders purchased stock in connection with the organization of Malaga Bank. MFC's common stock is traded in the OTC PINK market under the symbol MLGF.

MALAGA FINANCIAL CORPORATION AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

	DECEMBER 31	
	2015	**2014**
ASSETS		
Cash and due from banks	**$ 14,869,503**	$ 15,610,762
Federal funds sold	**61,213,211**	39,016,400
Cash and cash equivalents	**76,082,714**	54,627,162
Interest-bearing deposits in banks	**5,055,000**	5,068,000
Loans receivable, net of allowance for loan loss of $2,992,800 (2015) and $2,949,300 (2014)	**888,579,467**	872,797,597
Accrued interest receivable	**2,647,434**	2,646,001
Building, office properties, and equipment — net	**4,937,601**	5,196,988
Investment in FHLB stock — at cost	**6,236,200**	6,030,200
Other assets	**843,996**	915,580
TOTAL	**$ 984,382,412**	$ 947,281,528
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES:		
Deposits:		
Noninterest-bearing	**$ 97,660,468**	$ 86,562,497
Interest bearing	**659,197,805**	622,096,494
Total deposits	**756,858,273**	708,658,991
FHLB borrowings	**88,000,000**	104,900,000
Senior subordinated notes	**10,000,000**	10,000,000
Junior subordinated debentures	**13,404,000**	13,404,000
Accrued interest payable	**295,805**	272,416
Other liabilities	**2,635,627**	3,704,387
Deferred tax liability	**2,181,369**	2,116,401
Total liabilities	**873,375,074**	843,056,195
COMMITMENTS AND CONTINGENCIES (Note 4)		
STOCKHOLDERS' EQUITY:		
Common stock, $.001 par value — authorized, 20,000,000 shares; outstanding 6,080,349 shares (2015) and 6, 029,349 shares (2014)	**6,080**	6,029
Additional paid-in capital	**17,600,175**	16,608,373
Retained earnings	**93,401,083**	87,610,931
Total stockholders' equity	**111,007,338**	104,225,333
TOTAL	**$ 984,382,412**	$ 947,281,528

See notes to consolidated financial statements.

MALAGA FINANCIAL CORPORATION AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF OPERATIONS	YEARS ENDED DECEMBER 31	
	2015	**2014**
INTEREST INCOME:		
Loans	**$ 36,062,051**	$ 35,574,209
Other investments	**985,236**	613,271
Total interest income	**37,047,287**	36,187,480
INTEREST EXPENSE:		
Deposits	**2,510,126**	2,436,783
Borrowings	**2,927,612**	2,792,172
Senior subordinated notes	**925,000**	925,000
Junior subordinated debentures	**349,521**	341,992
Total interest expense	**6,712,259**	6,495,947
NET INTEREST INCOME	**30,335,028**	29,691,533
PROVISION FOR LOAN LOSSES	**38,053**	90,486
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	**30,296,975**	29,601,047
OTHER OPERATING INCOME	**618,618**	622,858
OTHER OPERATING EXPENSE:		
Compensation	**6,228,850**	5,943,139
Office rent and utilities	**1,020,073**	1,018,216
Professional services	**197,185**	247,228
Data processing	**898,418**	903,358
Deposit insurance premiums	**478,014**	443,338
Depreciation and amortization	**320,736**	348,334
General and administrative	**2,087,504**	1,967,063
Total other operating expense	**11,230,780**	10,870,676
INCOME BEFORE INCOME TAX EXPENSE	**19,684,813**	19,353,229
INCOME TAX EXPENSE	**8,278,618**	8,141,792
NET INCOME	**$ 11,406,195**	$ 11,211,437
BASIC EARNINGS PER SHARE	**$ 1.88**	$ 1.87
DILUTED EARNINGS PER SHARE	**$ 1.87**	$ 1.86

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

FOR THE YEARS ENDED DECEMBER 31, 2015 AND 2014

	Common Stock				
	Number of Shares	Amount	Additional Paid-in Capital	Retained Earnings	Total Stockholders' Equity
BALANCE — January 1, 2014	5,967,699	$ 5,968	$ 15,712,559	$ 81,360,664	$ 97,079,191
Net income	-	-	-	11,211,437	11,211,437
Cash dividends declared	-	-	-	(4,961,170)	(4,961,170)
Stock options exercised	61,650	61	760,214		760,275
Stock options compensation expense	-	-	27,600		27,600
Excess tax benefit from exercise of stock options	-	-	108,000		108,000
BALANCE — December 31, 2014	6,029,349	6,029	16,608,373	87,610,931	104,225,333
Net income	-	-	-	11,406,195	11,406,195
Cash dividends declared	-	-	-	(5,616,043)	(5,616,043)
Stock options exercised	51,000	51	720,219		720,270
Stock options compensation expense	-	-	119,232		119,232
Excess tax benefit from exercise of stock options	-	-	152,351		152,351
BALANCE — December 31, 2015	6,080,349	$ 6,080	$ 17,600,175	$ 93,401,083	$ 111,007,338

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	FOR YEARS ENDED DECEMBER 31	
	2015	**2014**
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	**$ 11,406,195**	$ 11,211,437
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of deferred loan fees — net of costs	**742,717**	753,888
Provision for loan losses	**38,053**	90,486
Excess tax benefit related to exercise of stock options	**(152,351)**	(108,000)
Depreciation and amortization	**320,736**	348,334
Net increase in deferred income taxes	**64,968**	72,000
Stock options compensation expense	**119,232**	27,600
Net decrease (increase) in accrued interest receivable and other assets	**70,151**	(118,335)
Net increase in accrued interest payable and other liabilities	**312,810**	343,579
Net cash provided by operating activities	**12,922,511**	12,620,989
CASH FLOWS FROM INVESTING ACTIVITIES:		
Net decrease (increase) in interest-bearing deposits in banks	**13,000**	(282,000)
Net increase in loans receivable	**(16,562,640)**	(49,842,529)
Purchase of FHLB stock	**(352,800)**	(2,011,400)
Redemption of FHLB stock	**146,800**	1,991,800
Purchase of premises and equipment	**(61,349)**	(134,043)
Net cash used in investing activities	**(16,816,989)**	(50,278,172)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase in deposits	**48,199,282**	74,754,739
Proceeds from FHLB borrowings	**35,000,000**	30,000,000
Repayment of FHLB borrowings	**(51,900,000)**	(52,985,000)
Dividends paid	**(6,821,873)**	(3,755,340)
Proceeds from exercise of stock options	**720,270**	760,275
Excess tax benefit related to exercise of stock options	**152,351**	108,000
Net cash provided by financing activities	**25,350,030**	48,882,674
NET INCREASE IN CASH AND CASH EQUIVALENTS	**21,455,552**	11,225,491
CASH AND CASH EQUIVALENTS — Beginning of year	**54,627,162**	43,401,671
CASH AND CASH EQUIVALENTS — End of year	**$ 76,082,714**	$ 54,627,162
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash paid during the year for:		
Interest	**$ 6,688,870**	$ 6,486,947
Income taxes	**$ 7,944,000**	$ 8,045,000
SUPPLEMENTAL SCHEDULE OF NONCASH FINANCING ACTIVITIES		
Dividend payable	**$**	$ 1,205,830

See notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2015 AND 2014

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 in the United States of America which determine 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 $8,894,000 and $7,646,000 at December 31, 2015 and 2014, respectively. As of December 31, 2015 and 2014, the Company had cash deposits at other financial institutions in excess of the FDIC insured limits. However, the Company places these deposits with major financial institutions and monitors the financial condition of these institutions, management believes the risk of loss to be minimal.

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 troubled debt restructurings 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-impaired 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, 2015 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 2012 for its federal filings and 2011 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 $0.90 and $0.80 per share of common stock in 2015 and 2014, 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 for the years ended December 31, 2015 and 2014, therefore, total comprehensive income equals net income.

Recent Accounting Pronouncements — As of January 1, 2015, the Company applied FASB ASU No. 2014-04, *Receivables – Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure.* ASU 2014-04 clarifies when a repossession or foreclosure has occurred. Additionally, the amendments require interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The Bank did not have any troubled debt restructured at December 31, 2015.

In January 2015, the FASB issued ASU No. 2015-01, Income Statement – Extraordinary and Unusual Items (Subtopic 225-20). The objective of this ASU is to simplify the income statement presentation requirements in Subtopic 225-20 by eliminating the concept of extraordinary items. Extraordinary items are events and transactions that are distinguished by their unusual nature and by the infrequency of their occurrence. Eliminating the extraordinary classification simplifies income statement presentation by altogether removing the concept of extraordinary items from consideration. This ASU is effective for annual periods and interim periods within those annual periods beginning after December 15, 2015 with early adoption permitted. The Bank does not expect this ASU to have a material impact on the Bank's consolidated financial statements.

2. LOANS RECEIVABLE

Loans receivable as of December 31, 2015 and 2014, are summarized as follows:

Description	2015	2014
Residential mortgage loans–multi-family	**$ 676,518,155**	$ 649,602,814
Residential mortgage loans–single family	**167,002,775**	173,938,924
Commercial real estate loans	**37,183,966**	40,144,669
Construction loans	**739,776**	2,356,666
Land loans	**527,700**	-
Business banking loans	**3,230,952**	3,971,354
Consumer loans	**272,641**	298,741
	885,475,965	870,313,168
Less:		
Allowance for loan losses	**(2,992,800)**	(2,949,300)
Deferred loan costs–net of fees	**6,096,302**	5,433,729
	3,103,502	2,484,429
Total	**$ 888,579,467**	$ 872,797,597

As of December 31, 2015 and 2014, 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 $882.8 million and $867.2 million, respectively, and loans with fixed rates of interest totaled $2.7 million and $3.2 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, 2015 and 2014, real estate loans aggregating $648.6 million and $624.3 million, respectively, were pledged as collateral against FHLB borrowings and real estate loans totaling $145.0 million and $146.1 million, respectively, were pledged to secure deposits held by the state of California. In addition, home equity lines of credit totaling $6.4 million and $9.4 million were pledged as collateral to the Federal Reserve Bank discount window at December 31, 2015 and 2014, respectively.

Activity in the allowance for loan losses and unfunded loan commitments for the years ended December 31, 2015 and 2014 is summarized as follows:

	2015	2014
Allowance for loan losses:		
Balance — beginning of year	**$ 2,949,300**	$2,866,400
Provision for loan losses	**39,153**	87,886
(Charge-offs) recoveries, net	**4,347**	(4,986)
Balance — end of year	$2,992,800	$2,949,300
Reserve for unfunded loan commitments:		
Balance — beginning of year	**$ 56,600**	$ 54,000
Provision for (recovery of) losses on unfunded loan commitments	**(1,100)**	2,600
Balance — end of year	**$ 55,500**	$ 56,600

A breakdown of the allowance for loan losses as of December 31, 2015 and 2014, by loan type, is as follows:

	Multi-Family	Single Family	Commercial	Construction	Land	Business Banking	Consumer	Total
Balance - December 31, 2013	$ 2,202,883	$ 554,056	$ 46,013	$ 30,575	$ -	$ 10,467	$ 22,406	**$ 2,866,400**
Charge-offs	-	-	-	-	-	-	(4,986)	**(4,986)**
Recoveries	-	-	-	-	-	-	-	**-**
Provision for (recovery of) loan losses	63,499	14,163	(5,137)	34,557	-	(3,316)	(15,880)	**87,886**
Balance - December 31, 2014	$ 2,266,382	$ 568,219	$ 40,876	$ 65,132	$ -	$ 7,151	$ 1,540	**$ 2,949,300**
Charge-offs	-	-	-	-	-	-	-	**-**
Recoveries	-	-	-	-	-	-	4,347	**4,347**
Provision for (recovery of) loan losses	150,818	(73,719)	4,724	(49,532)	11,100	(851)	(3,387)	**39,153**
Balance - December 31, 2015	$ 2,417,200	$ 494,500	$ 45,600	$ 15,600	$ 11,100	$ 6,300	$ 2,500	**$ 2,992,800**

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 are no loans considered to be impaired at December 31, 2015 and two loans in the amount of $46,000 considered to be impaired at December 31, 2014. These loans also represent the Company's only troubled debt restructuring as of December 31, 2014. 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 $4,200 at December 31, 2014. A specific allowance of $4,200 was recovered in 2015. The average recorded investment in impaired loans during the years ended December 31, 2015 and 2014 was $42,000 and $321,000, respectively. Interest income of $1,148 and $22,887 was recognized on impaired loans during the years ended December 31, 2015 and 2014, respectively, all of which was received in cash. There were no troubled debt restructuring that defaulted within twelve months of modification during the years ended December 31, 2015 or 2014, respectively.

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, 2015 and 2014, are summarized as follows:

	December 31, 2015				
	Pass	Special Mention	Substandard	Doubtful	Total
Residential mortgage loans — multi-family	$ 676,097,271	$ -	$ 420,884	$ -	**$ 676,518,155**
Residential mortgage loans — single family	167,002,775	-	-	-	**167,002,775**
Commercial loans	36,980,496	-	203,470	-	**37,183,966**
Construction loans	739,776	-	-	-	**739,776**
Land loans	527,700	-	-	-	**527,700**
Business banking loans	3,230,952	-	-	-	**3,230,952**
Consumer loans	272,641	-	-	-	**272,641**
Total	$ 884,851,611	$ -	$ 624,354	$ -	**$ 885,475,965**

	December 31, 2014				
	Pass	Special Mention	Substandard	Doubtful	Total
Residential mortgage loans — multi-family	$ 648,781,842	$ -	$ 820,972	$ -	**$ 649,602,814**
Residential mortgage loans — single family	173,402,702	38,639	497,583	-	**173,938,924**
Commercial loans	39,485,459	-	659,210	-	**40,144,669**
Construction loans	2,356,666	-	-	-	**2,356,666**
Business banking loans	3,968,442	-	2,912	-	**3,971,354**
Consumer loans	298,741	-	-	-	**298,741**
Total	$ 868,293,852	$ 38,639	$ 1,980,677	$ -	**$ 870,313,168**

There were no loans past due as of December 31, 2015 and 2014. There were no nonaccrual loans at December 31, 2015 and one business banking loan with a net outstanding balance of $2,900 at December 31, 2014 on nonaccrual status.

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 $325,779 and $355,951 in 2015 and 2014, respectively.

A summary of related-party loan activity for the years ended December 31, 2015 and 2014 is as follows:

	2015	2014
Beginning balance	**$ 8,603,245**	$ 9,603,465
Credit granted — including renewals	**987,700**	100
Repayments	**(413,459)**	(1,000,320)
Ending balance	**$ 9,177,486**	$ 8,603,245

3. BUILDING, OFFICE PROPERTIES, AND EQUIPMENT

Building, office properties, and equipment as of December 31, 2015 and 2014, are summarized as follows:

Description	2015	2014
Land	**$ 1,275,364**	$ 1,275,364
Building	**3,553,211**	3,553,211
Leasehold improvements	**1,845,538**	1,856,368
Equipment	**1,593,830**	1,543,221
Furniture and fixtures	**648,921**	644,299
Construction in progress	**6,778**	5,159
	8,923,642	8,877,622
Accumulated depreciation and amortization	**(3,986,041)**	(3,680,634)
Total	**$ 4,937,601**	$ 5,196,988

Depreciation and amortization expense for the years ended December 31, 2015 and 2014 was $320,736 and $348,334, 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 $10.8 million and $5.3 million, undisbursed funds for construction loans of $2.0 million and $2.7 million, and undrawn lines of credit previously granted of approximately $25.0 million and $27.9 million at December 31, 2015 and 2014, 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, 2015 and 2014.

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 $45,000 and $436,000 at December 31, 2015 and 2014.

Leases — The Company leases office premises under operating leases that expire at various dates through September 24, 2022. Rental expense was $674,674 and $662,492 for the years ended December 31, 2015 and 2014, respectively. The projected minimum rental payments under the terms of the leases as of December 31, 2015, are as follows:

Years Ending December 31	
2016	$ 668,352
2017	668,352
2018	668,352
2019	431,553
2020	248,232
Thereafter	326,487
Total	$ 3,011,328

5. DEPOSITS

Deposit balances and the weighted-average interest rates for each category of deposits as of December 31, 2015 and 2014, are summarized as follows:

	2015		2014	
	Interest Rate	Amount	Interest Rate	Amount
Demand deposits	- %	$ 97,660,468	- %	$ 86,562,597
NOW accounts	0.13	70,129,759	0.20	61,072,406
Passbooks	0.16	42,362,158	0.25	35,845,496
Money market accounts	0.22	288,068,359	0.39	242,386,612
Certificates of deposit - less than $250,000	0.69	133,933,820	0.71	132,596,068
Certificates of deposit - $250,000 and over	0.35	124,703,709	0.31	150,195,812
Total	0.28	$ 756,858,273	0.36	$708,658,991

Certificates of deposit maturities as of December 31, 2015, are summarized as follows:

Years Ending December 31	
2016	$ 211,152,946
2017	15,275,527
2018	6,292,270
2019	14,497,407
2020	11,419,379
Total	$ 258,637,529

As of December 31, 2015 and 2014, the Company had certificates of deposit from the state of California Treasurer's Office of $82 million and $96 million, respectively.

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 $3,706,748 and $3,194,539, at December 31, 2015 and 2014, 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 2.69% as of December 31, 2015. 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, 2015, are summarized as follows:

Years Ending December 31	
2016	$18,000,000
2017	5,000,000
2019	25,000,000
2020	20,000,000
Thereafter	20,000,000
Total	$88,000,000

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 3.70% per annum at December 31, 2015.

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 2.28% per annum at December 31, 2015.

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 2.28% per annum at December 31, 2015.

9. INCOME TAXES

A summary of income tax expense for the years ended December 31, 2015 and 2014 is as follows:

	2015	2014
Current:		
State	**$ 2,072,301**	$ 2,037,773
Federal	**6,141,349**	6,032,019
Total current	**8,213,650**	8,069,792
Deferred:		
State	**18,960**	42,218
Federal	**46,008**	29,782
Total deferred	**64,968**	72,000
Total	**$ 8,278,618**	$ 8,141,792

The components of the net deferred liability as of December 31, 2015 and 2014 are as follows:

	2015	2014
FEDERAL		
Deferred tax liabilities:		
Loan fees/costs	**$ (3,004,838)**	$ (2,861,230)
FHLB dividends	**(531,625)**	(548,350)
Depreciation	**(61,415)**	(106,216)
Other	**(70,705)**	(91,760)
Gross deferred tax liability	**(3,668,583)**	(3,607,556)
Deferred tax assets:		
California franchise tax	**979,905**	961,184
Depreciation	-	-
Bad debt and loan loss deduction	**1,066,905**	1,053,540
Other	**167,830**	184,898
Gross deferred tax asset	**2,214,640**	2,199,622
Net deferred tax liability	**$ (1,453,943)**	$ (1,407,934)

	2015	2014
STATE		
Deferred tax liabilities:		
Loan fees/costs	**$ (930,641)**	$ (886,164)
FHLB dividends	**(164,652)**	(169,831)
Depreciation	-	-
Other	**(21,899)**	(28,419)
Gross deferred tax liability	**(1,117,192)**	(1,084,414)
Deferred tax assets:		
California franchise tax	-	-
Depreciation	**28,306**	29,294
Bad debt and loan loss deduction	**330,436**	326,296
Other	**31,024**	20,357
Gross deferred tax asset	**389,766**	375,947
Net deferred tax liability	**$ (727,426)**	$ (708,467)

A reconciliation of total income tax expense for 2015 and 2014 to the expected tax expense computed by applying the statutory corporate income tax rate to pretax income for the years ended December 31, 2015 and 2014 is as follows:

	2015		2014	
	Amount	**Percent**	**Amount**	**Percent**
Tax expense at statutory rates	**$ 6,889,684**	35%	$ 6,773,630	35%
State franchise tax — net of federal benefit	**1,359,320**	7	1,351,994	7
Other	**29,614**	-	16,168	-
Total	**$ 8,278,618**	42%	$ 8,141,792	42%

10. REGULATORY CAPITAL

The Federal Reserve and the Federal Deposit Insurance Corporation approved final capital rules in July 2013 that substantially amend the existing capital rules for banks. These new rules reflect, in part, certain standards initially adopted by the Basel Committee on Banking Supervision in December 2010 (which standards are commonly referred to as "Basel III") as well as requirements contemplated by the Dodd-Frank Act.

Under the new capital rules, the Bank is required to meet certain minimum capital requirements that differ from previous capital requirements. The rules implemented a new capital ratio of common equity Tier 1 capital to risk-weighted assets. Common equity Tier 1 capital generally consists of retained earnings and common stock (subject to certain adjustments). The Bank is also required to establish a "conservation buffer," consisting of a common equity Tier 1 capital amount equal to 2.5% of risk-weighted assets to be phased in by 2019. An institution that does not meet the conservation buffer requirement will be subject to restrictions on certain activities including payment of dividends, stock repurchases, and discretionary bonuses to executive officers.

The Prompt Corrective Action rules have been modified to include the common equity Tier 1 capital ratio and to increase the Tier 1 capital ratio requirements for various thresholds. For example, the requirements for the Bank to be considered well-capitalized under the rules will be a 5.0% leverage ratio, a 6.5% common equity Tier 1 capital ratio, an 8.0% Tier 1 capital ratio, and a 10.0% total capital ratio. To be adequately capitalized, those ratios are 4.0%, 4.5%, 6.0%, and 8.0%, respectively. As of December 31, 2015 and 2014, the Bank met all applicable regulatory capital requirements.

The rules modify the manner in which certain capital elements are determined. The rules make changes to the methods of calculating the risk-weighting of certain assets, which in turn affects the calculation of the risk-weighted capital ratios. Higher

risk weights are assigned to various categories of assets, including commercial real estate loans, credit facilities that finance the acquisition, development or construction of real property, certain exposures or credit that are 90 days past due or are nonaccrual status, securitization exposures, and, in certain cases, mortgage servicing rights and deferred tax assets.

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 capital amounts and classification of the Bank 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.

As of December 31, 2015 and 2014, 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, Common Tier 1 capital, 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, 2015:						
Tier 1 capital to average assets	$ 132,731,351	13.20%	$ 40,220,501	4.00%	$ 50,275,626	5.00%
Total capital to risk-weighted assets	135,779,651	25.32	42,901,288	8.00	53,626,609	10.00
Common Tier 1 capital to risk-weighted assets	132,731,351	24.75	24,131,974	4.50	34,857,296	6.50
Tier 1 capital to risk-weighted assets	132,731,351	24.75	32,175,966	6.00	42,901,288	8.00
As of December 31, 2014:						
Total capital to risk-weighted assets	$ 128,339,159	24.08%	$ 42,629,643	8.00%	$ 53,287,053	10.00%
Core capital to adjusted tangible assets	125,389,860	13.25	37,858,245	4.00	47,322,806	5.00
Tangible capital to adjusted tangible assets	125,389,860	13.25	14,196,842	1.50	N/A	N/A
Tier 1 capital to risk-weighted assets	125,389,860	23.53	N/A	N/A	31,972,232	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. No options may be granted under the 2007 Director Plan after January 1, 2017.

Pursuant to the adoption of ASC Topic 718, *Stock Compensation*, stock-based compensation expense was $119,232 and $27,600 for 2015 and 2014, 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 $152,351 and $108,000 for 2015 and 2014, respectively, and cash provided by financing activities increased by identical amounts for both 2015 and 2014 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, 2015, is as follows:

	Number of Options	Weighted–Average Exercise Price	Weighted-Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value
Outstanding — beginning of year	221,700	$ 15.74		$ 1,390,059
Granted	55,200	20.95		58,512
Exercised	(51,000)	14.12		(402,240)
Canceled	(100)	12.95		(906)
Outstanding — end of year	225,800	$ 17.38	2.44	$ 643,614
Vested and exercisable — year-end	170,600	$ 16.22	1.93	$ 585,102
Shares available	505,265			

The status of shares subject to options and exercise price during the year ended December 31, 2014, is as follows:

	Number of Options	Weighted–Average Exercise Price	Weighted-Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value
Outstanding — beginning of year	238,715	$ 13.98		
Granted	55,200	19.04		
Exercised	(61,650)	12.33		
Canceled	(10,565)	13.29		
Outstanding — end of year	221,700	$ 15.74	2.36	$ 956,918
Vested and exercisable — year-end	166,500	$ 14.64	1.81	$ 956,918
Shares available	560,365			

Information pertaining to options outstanding as of December 31, 2015, 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
$12.00–$15.99	69,400	1.02	$ 13.58	69,400	$ 13.58
$16.00–$21.00	156,400	3.06	19.06	101,200	18.03
Total	225,800	2.44	$ 17.38	170,600	$ 16.22

Certain information regarding options for the years ended December 31, 2015 and 2014 is as follows:

	2015	2014
Weighted-average fair value of stock options granted during the year	$ 2.16	$ 0.50
Total intrinsic value of options exercised	402,240	580,612
Total fair value of shares vested	27,600	30,820

As of December 31, 2015 and 2014, total unrecognized compensation costs related to options was less than $1.

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:

	2015	2014
Expected life (1)	5 year	5 year
Expected volatility (2)	16.38%	7.50%
Expected dividend yield (3)	3.68	3.68
Risk-free interest rate (4)	1.64	1.58

(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, 2015 and 2014 is as follows. For the years ended December 31, 2015 and 2014, 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.

	2015			2014		
	Income (Numerator)	Shares (Denominator)	Per-Share Amount	Income (Numerator)	Shares (Denominator)	Per-Share Amount
Basic EPS						
Income available to common stockholders	$ 11,406,195	6,066,914	$ 1.88	$ 11,211,437	6,008,324	$ 1.87
Effect of Dilutive Securities						
Options — common stock equivalents		26,055	(0.01)		33,626	(0.01)
Diluted EPS						
Income available to common stockholders, plus assumed conversion	$ 11,406,195	6,092,969	$ 1.87	$ 11,211,437	6,041,950	$ 1.86

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 $7,000 at December 31, 2014. There were no impaired loans at December 31, 2015. Total losses related to this impaired loan were immaterial during the year ended December 31, 2014.

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, 2015 and 2014:

2015

			Fair Value Measurement Using		
	Carrying Amount	**Estimated Fair Value**	**Level 1**	**Level 2**	**Level 3**
Assets:					
Cash and cash equivalents	$ 76,083,000	$ 76,083,000	$ 76,083,000	$ -	$ -
Interest-bearing deposits in banks	5,055,000	5,055,000	-	5,055,000	-
Loans receivable	888,579,000	921,102,000	-	-	921,102,000
Accrued interest receivable	2,647,000	2,646,000	2,646,000	-	-
Investment in FHLB stock	6,236,000	6,236,000	-	6,236,000	-
Liabilities:					
Deposits	756,858,000	756,637,000	-	756,637,000	-
FHLB borrowings	88,000,000	87,955,000	-	87,955,000	-
Senior subordinated notes	10,000,000	10,748,000	-	10,748,000	-
Junior subordinated debentures	13,404,000	7,985,000	-	7,985,000	-
Accrued interest payable	296,000	296,000	296,000	-	-

2014			Fair Value Measurement Using		
	Carrying Amount	Estimated Fair Value	Level 1	Level 2	Level 3
Assets:					
Cash and cash equivalents	$ 54,627,000	$ 54,627,000	$ 54,627,000	$ -	$ -
Interest-bearing deposits in banks	5,086,000	5,086,000	-	5,086,000	-
Loans receivable	872,798,000	925,448,000	-	-	925,448,000
Accrued interest receivable	2,646,000	2,646,000	2,646,000	-	-
Investment in FHLB stock	6,030,000	6,030,000	-	6,030,000	-
Liabilities:					
Deposits	708,659,000	708,836,000	-	708,836,000	-
FHLB borrowings	104,900,000	106,893,000	-	106,893,000	-
Senior subordinated notes	10,000,000	10,731,000	-	10,731,000	-
Junior subordinated debentures	13,404,000	8,038,000	-	8,038,000	-
Accrued interest payable	272,000	272,000	272,000	-	-

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 at 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 one-year and two-year Treasury bond as of December 31, 2015 and 2014, 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, 2015 and 2014. 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 11, 2016, 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 Stockholders of
Malaga Financial Corporation
Palos Verdes Estates, California

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Malaga Financial Corporation and its subsidiary (the "Company"), which comprise the consolidated balance sheets as of December 31, 2015 and 2014, and the related consolidated statements of income, stockholders' equity and cash flows for the years then ended, and the related notes to the 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 consolidated 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 we have 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, 2015 and 2014, and the results of their operations and 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 11, 2016

BOARD OF DIRECTORS AND OFFICERS

BOARD OF DIRECTORS

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Chairman of the Board

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

Randy C. Bowers*

Raymond L. Craemer, M.D.*

Leo K. C. Lee*

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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Carmela Carroll
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Nina Brister
Vice President
Loan Service/Funding Manager

Cathy Jaramillo
Vice President
Loan Processing Manager

*Directors or Officers of MFC and Malaga Bank.

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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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