

**Independence Bank, N.A.**  
Financial Statements  
For the Years Ended December 31, 2008 and 2007

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To the Board of Directors  
Independence Bank, N.A.  
Houston, Texas

Independent Auditor's Report

We have audited the accompanying balance sheets of Independence Bank, N.A. (the "Bank") as of December 31, 2008 and 2007, and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Independence Bank, N.A. as of December 31, 2008, and 2007, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

*Briggs & Veselka Co.*

Briggs & Veselka Co.  
A Professional Corporation  
Certified Public Accountants

March 3, 2009

INDEPENDENCE BANK, N.A.  
BALANCE SHEETS  
DECEMBER 31, 2008 AND 2007

ASSETS	2008	2007
Cash and due from banks	\$ 2,933,688	\$ 2,517,109
Federal funds sold	<u>5,871,968</u>	<u>12,949,818</u>
Total Cash and Cash Equivalents	<b>8,805,656</b>	15,466,927
Interest bearing deposits in financial institutions	<b>1,000,000</b>	5,000,000
Securities available-for-sale	<b>32,334,141</b>	35,706,783
Federal Home Loan Bank stock	<b>220,400</b>	214,300
Federal Reserve Bank stock	<b>437,900</b>	423,300
The Independent Bankers Bank stock	<b>75,000</b>	75,000
Loans, net of allowance for loan losses of \$1,284,859 and \$920,792 at December 31, 2008 and 2007, respectively	<b>92,342,312</b>	77,935,736
Accrued interest receivable	<b>897,137</b>	804,134
Premises and equipment, net	<b>1,006,516</b>	1,206,841
Other real estate, net	-	380,013
Deferred tax assets	<b>456,973</b>	646,689
Other assets	<u>299,609</u>	<u>297,105</u>
TOTAL ASSETS	<u><b>\$ 137,875,644</b></u>	<u>\$ 138,156,828</u>

*The accompanying notes are an integral part of these financial statements.*

<u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>	<u>2008</u>	<u>2007</u>
<b>LIABILITIES</b>		
Deposits:		
Demand	\$ 21,414,812	\$ 20,208,747
Savings and money market	31,043,636	55,330,057
Time	<u>70,432,962</u>	<u>48,130,662</u>
Total Deposits	122,891,410	123,669,466
Accrued interest and other liabilities	<u>175,744</u>	<u>190,381</u>
<b>TOTAL LIABILITIES</b>	<b><u>123,067,154</u></b>	<b><u>123,859,847</u></b>
<b>STOCKHOLDERS' EQUITY</b>		
Common stock, \$1 par value; 3,000,000 shares authorized, 1,594,441 shares issued and outstanding		
	1,594,441	1,594,441
Paid-in capital – stock options and warrants	107,765	-
Capital surplus	13,944,559	13,944,559
Retained deficit	(1,071,074)	(1,237,822)
Accumulated other comprehensive income (loss), net of tax	<u>232,799</u>	<u>(4,197)</u>
<b>TOTAL STOCKHOLDERS' EQUITY</b>	<b><u>14,808,490</u></b>	<b><u>14,296,981</u></b>
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b><u>\$ 137,875,644</u></b>	<b><u>\$ 138,156,828</u></b>

*The accompanying notes are an integral part of these financial statements.*

INDEPENDENCE BANK, N.A.  
 STATEMENTS OF INCOME  
 FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007

	2008	2007
<b>INTEREST INCOME</b>		
Interest and fees on loans	\$ 6,183,316	\$ 6,405,663
Investment securities	1,405,251	1,454,445
Federal funds sold	185,854	706,153
Other investments	162,712	601,828
Total Interest Income	<u>7,937,133</u>	<u>9,168,089</u>
<b>INTEREST EXPENSE</b>		
Deposits	3,076,922	4,368,377
Other borrowings	12,033	107
Total Interest Expense	<u>3,088,955</u>	<u>4,368,484</u>
Net interest income	4,848,178	4,799,605
Provision for loan losses	396,000	66,000
Net Interest Income After Provision for Loan Losses	<u>4,452,178</u>	<u>4,733,605</u>
<b>NONINTEREST INCOME</b>		
Customer service fees	279,838	224,401
Net realized gain on sale of available-for-sale securities	247,988	8,209
Net gain on sale of real estate owned	28,399	-
Total Noninterest Income	<u>556,225</u>	<u>232,610</u>
<b>NONINTEREST EXPENSES</b>		
Salaries and employee benefits	2,675,396	2,454,833
Occupancy and equipment expenses	795,175	760,384
Data processing	306,273	382,785
Office expense	178,658	216,489
Professional services	400,863	362,342
Advertising and business development	78,385	62,692
Other	339,278	326,859
Total Noninterest Expenses	<u>4,774,028</u>	<u>4,566,384</u>
NET INCOME BEFORE TAXES	234,375	399,831
Income tax (expense) benefit	(67,627)	319,565
NET INCOME	<u>\$ 166,748</u>	<u>\$ 719,396</u>

*The accompanying notes are an integral part of these financial statements.*

INDEPENDENCE BANK, N.A.  
 STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY  
 FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007

	Common Stock	Paid in Capital- Stock Options and Warrants	Capital Surplus	Retained Deficit	Accumulated Other Comprehensive Income (Loss), Net of Tax	Total Stockholders' Equity
BALANCE, DECEMBER 31, 2006	\$ 1,594,441	\$ -	\$ 13,944,559	\$ (1,957,218)	\$ (144,850)	\$ 13,436,932
Net income	-	-	-	719,396	-	
Change in unrealized loss on securities, net of deferred income tax benefit of \$72,457	-	-	-	-	140,653	
Total comprehensive income	-	-	-	719,396	140,653	860,049
BALANCE, DECEMBER 31, 2007	1,594,441	-	13,944,559	(1,237,822)	(4,197)	14,296,981
<b>Compensation cost related to stock options and warrants</b>	-	<b>107,765</b>	-	-	-	<b>107,765</b>
<b>Net income</b>	-	-	-	<b>166,748</b>	-	
<b>Change in unrealized loss on securities, net of deferred income tax benefit of \$122,089</b>	-	-	-	-	<b>236,996</b>	
<b>Total comprehensive income</b>	-	-	-	<b>166,748</b>	<b>236,996</b>	<b>403,744</b>
<b>BALANCE, DECEMBER 31, 2008</b>	<b>\$ 1,594,441</b>	<b>\$ 107,765</b>	<b>\$ 13,944,559</b>	<b>\$ (1,071,074)</b>	<b>\$ 232,799</b>	<b>\$ 14,808,490</b>

The accompanying notes are an integral part of these financial statements.

INDEPENDENCE BANK, N.A.  
STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007

	2008	2007
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	<u>\$ 166,748</u>	<u>\$ 719,396</u>
ADJUSTMENTS TO RECONCILE NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Items not requiring (providing) cash:		
Depreciation and amortization	330,649	321,928
Provision for loan losses	396,000	66,000
Amortization of premiums and discounts on securities	(3,359)	(6,816)
Net realized gains on sale of securities available-for-sale	(247,988)	(8,209)
Net gain on sale of real estate owned	(28,399)	-
Reinvested dividends	(20,700)	(67,300)
Compensation costs related to stock options	107,765	-
Deferred tax assets	67,627	(319,565)
(Increase) decrease in assets:		
Interest receivable	(93,003)	(194,424)
Other assets	(31,424)	(512,891)
Increase (decrease) in liabilities:		
Accounts payable and accrued expenses	<u>(14,637)</u>	<u>67,269</u>
Total Adjustments	<u>462,531</u>	<u>(654,008)</u>
Net Cash Provided by Operating Activities	<u>629,279</u>	<u>65,388</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Net change in interest bearing deposits in financial institutions	4,000,000	9,100,000
Purchase of securities available-for-sale	(50,821,148)	(29,684,869)
Proceeds from sales of securities available-for-sale	42,328,157	2,300,158
Proceeds from maturities, calls and paydowns of securities	12,474,659	18,350,020
Proceeds from the sale of other real estate	741,822	36,697
Net expenditures on other real estate	(76,877)	-
Net change in loans	(15,059,109)	(13,877,862)
Purchases of premises and equipment, net	(99,998)	(72,622)
Purchase of The Independent Bankers Bank stock	<u>-</u>	<u>(75,000)</u>
Net Cash Used by Investing Activities	<u>(6,512,494)</u>	<u>(13,923,478)</u>

*The accompanying notes are an integral part of these financial statements.*

INDEPENDENCE BANK, N.A.  
 STATEMENTS OF CASH FLOWS (CONTINUED)  
 FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007

	<u>2008</u>	<u>2007</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Net change in demand, savings and money market deposits	(23,080,356)	24,199,812
Net change in certificates of deposits	<u>22,302,300</u>	<u>(10,603,357)</u>
Net Cash Provided (Used) by Financing Activities	<u>(778,056)</u>	<u>13,596,455</u>
Net decrease in cash and cash equivalents	(6,661,271)	(261,635)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	<u>15,466,927</u>	<u>15,728,562</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>\$ 8,805,656</u>	<u>\$ 15,466,927</u>
 <b><u>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION</u></b>		
Cash Paid During the Year for Interest	<u>\$ 2,983,673</u>	<u>\$ 4,301,463</u>
Real Estate Acquired in Settlement of Loans	<u>\$ 256,533</u>	<u>\$ 416,710</u>

*The accompanying notes are an integral part of these financial statements.*

NOTE 1 – NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING AND REPORTING POLICIES

Nature of Operations

Independence Bank, N.A. (formerly The Right Bank of Texas, N.A.) (the “Bank”) is a national banking association headquartered in Houston, Texas. The Bank began operations May 13, 2002.

The Bank provides a broad line of financial products and services for small to medium sized businesses and consumers through its three community banking facilities in the Houston area. The main source of revenue for the Bank is from investing the funds received from depositors and providing loans and other banking services to its customers.

Summary of Significant Accounting and Reporting Policies

A. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses and the valuation of real estate acquired in connection with foreclosures or in satisfaction of loans. In connection with the determination of the allowances for losses on loans and foreclosed real estate, management obtains independent appraisals for significant properties.

The allowance for loan losses is maintained at a level which, in management’s judgment, is adequate to absorb credit losses inherent in the loan portfolio. The amount of the allowance is based on management’s evaluation of the collectability of the loan portfolio, including the nature of the portfolio, credit concentrations, trends in historical loss experience, specific impaired loans, and economic conditions. Allowances for impaired loans are generally determined based on collateral values or the present value of estimated cash flows. Because of uncertainties associated with regional economic conditions, collateral values, and future cash flows on impaired loans, it is reasonably possible that management’s estimate of credit losses inherent in the loan portfolio and the related allowance may change materially in the near term. The allowance is increased by a provision for loan losses, which is charged to expense and reduced by charge-offs, net of recoveries. Changes in the allowance relating to impaired loans are charged or credited to the provision for loan losses.

NOTE 1 – NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING AND REPORTING POLICIES (CONTINUED)

Summary of Significant Accounting and Reporting Policies (Continued)

B. Cash and Cash Equivalents

For the purpose of presentation in the statements of cash flows, cash and cash equivalents include cash, federal funds sold and due from banks. Generally, the Bank considers all highly liquid debt instruments with original maturities of three (3) months or less to be cash equivalents. In monitoring credit risk associated with these uninsured deposits, the Bank periodically evaluates the stability of the correspondent financial institutions.

C. Investment Securities

The Bank reviews its financial position, liquidity, and future plans in evaluating the criteria for classifying investment securities. The Bank classifies its debt securities in accordance with Statement of Financial Accounting Standards No. 115, “*Accounting for Certain Investments in Debt and Equity Securities.*”

1. Held-to-Maturity Securities

Bonds, notes, and debentures for which the Bank has the positive intent and ability to hold to maturity are reported at cost, adjusted for premiums and discounts that are recognized in interest income using the interest method over the period to maturity.

2. Available-for-Sale Securities

Available-for-sale securities consist of bonds, notes, debentures, and certain equity securities not classified as trading securities nor as held-to-maturity securities. Unrealized holding gains and losses, net of tax, on available-for-sale securities are reported as a net amount in a separate component of stockholders’ equity until realized. Gains and losses on the sale of available-for-sale securities are determined using the specific-identification method. Declines in the fair value of individual available-for-sale securities below their cost that are other than temporary result in write-downs of the individual securities to their fair value. The related write-downs are included in earnings as realized losses. Premiums and discounts are recognized in interest income using the interest method over the period to maturity.

D. Loans Receivable

Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at their outstanding unpaid principal balances reduced by any charge-offs or specific valuation accounts and net of any deferred fees or costs on originated loans.

NOTE 1 – NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING AND REPORTING POLICIES (CONTINUED)

Summary of Significant Accounting and Reporting Policies (Continued)

D. Loans Receivable (Continued)

Interest income is recognized based upon principal amounts outstanding. The accrual of interest on a loan is discontinued when, in the opinion of management, there is doubt about the ability of the borrower to pay interest or principal. Interest previously accrued but uncollected on such loans is reversed and charged against current income. Subsequent interest collected on such loans is credited to loan principal if, in the opinion of management, collectability of principal is doubtful; otherwise, the interest collected is recognized as income and resumption of interest accruals may occur. Loans are charged off as uncollectible when, in the opinion of management, collectability of principal is improbable.

The allowance is increased by a provision for loan losses, which is charged to expense, and reduced by charge-offs, net of recoveries. Management's periodic evaluation of the adequacy of the allowance is based on the current level of net loan losses, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, and current economic conditions. Allowances for impaired loans are generally determined based on collateral values or the present value of estimated cash flows.

Loans are considered past due or delinquent based on the contractual terms in the loan agreement and how recently repayments have been received.

E. Other Real Estate

Other real estate consists of properties acquired through a foreclosure proceeding or acceptance of a deed in lieu of foreclosure. These properties are carried at the lower of cost or fair market value based on appraisal value. Loan losses arising from the acquisition of such properties are charged against the allowance for possible loan losses; subsequent valuation adjustments are charged to expense, and the basis of the properties is reduced accordingly. These properties are not held for the production of income and, therefore, are not depreciated. Significant improvements to increase resale value are capitalized and added to the value of the property.

F. Premises and Equipment

Bank premises, furniture and equipment, and leasehold improvements are carried at cost, less accumulated depreciation and amortization computed principally by the straight-line method over the estimated useful lives of the assets. Maintenance and repairs, which do not extend the life of banking premises and equipment, are charged to expense.

NOTE 1 – NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING  
AND REPORTING POLICIES (CONTINUED)

Summary of Significant Accounting and Reporting Policies (Continued)

G. Stock Options

At December 31, 2008, the Bank has a stock-based employee compensation plan, which is described more fully in *Note 17*. Effective January 1, 2006, the Bank adopted the fair value recognition provisions of Statement of Financial Accounting Standards (SFAS) No. 123R, “*Share-Based Payment*”. The Bank selected the modified prospective application. Accordingly, after January 1, 2006, the Bank began expensing the fair value of stock options granted, modified, repurchased or cancelled.

H. Income Taxes

Income taxes are provided for the tax effects of transactions reported in the financial statements and consist of taxes currently due plus deferred taxes related primarily to allowance for loan losses and accumulated depreciation for financial and income tax reporting. The deferred tax assets and liabilities represent the future tax return consequences of those differences, which will either be taxable or deductible when the assets and liabilities are recovered or settled.

Deferred tax assets and liabilities are reflected at income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. A valuation allowance is established to reduce deferred tax assets if it is more likely than not that a deferred tax asset will not be realized. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

In July 2006, the FASB issued Interpretation No. 48, “*Accounting for Uncertainty in Income Taxes*” (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise’s financial statements in accordance with Statement No. 109, “*Accounting for Income Taxes*”. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition of tax benefits, classification on the balance sheets, interest and penalties, accounting in interim periods, disclosure and transition.

In December 2008, the FASB provided for a deferral of the effective date of FIN 48 for certain nonpublic enterprises to annual financial statements for fiscal years beginning after December 15, 2008. The Bank has elected this deferral and, accordingly, will be required to adopt FIN 48 in its 2009 annual financial statements. Prior to adoption of FIN 48, the Bank will continue to evaluate its uncertain tax positions and related income tax contingencies under Statement No. 5, “*Accounting for Contingencies*”. SFAS No. 5 requires the Bank to accrue for losses it believes are probable and can be reasonably estimated. An analysis of the impact of FIN 48 is not yet complete; however, upon adoption, the Bank expects any adjustments required to be reported will not be material to its financial statements.

NOTE 1 – NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING  
AND REPORTING POLICIES (CONTINUED)

Summary of Significant Accounting and Reporting Policies (Continued)

I. State Margin Taxes

In May 2006, the State of Texas enacted a bill that replaced the existing franchise tax with a margin tax. Effective January 1, 2007, the margin tax applies to legal entities conducting business in Texas, including previously nontaxable entities such as limited partnerships and limited liability partnerships. The tax is calculated by applying a tax rate to a base that considers both revenues and expenses and, therefore, has the characteristics of an income tax. As a result, the Bank recorded approximately \$16,000 and \$12,000 in state income tax for the years ended December 31, 2008 and 2007, respectively.

J. Financial Instruments with Off-Balance-Sheet Risk

In the ordinary course of business, the Bank has entered into off-balance-sheet financial instruments consisting of commitments to extend credit. Such financial instruments are recorded in the financial statements when they are funded or related fees are incurred or received.

K. Fair Values of Financial Instruments

The Company has determined the fair value of certain assets and liabilities through application of Statement of Financial Accounting Standard No. 157, "*Fair Value Measurements*". Financial assets and liabilities valued using Level 1 inputs are based on unadjusted quoted market prices within active markets. Financial assets and liabilities valued using Level 2 inputs are based primarily on quoted prices for similar assets or liabilities in active or inactive markets. Financial assets and liabilities using Level 3 inputs were primarily valued using management's assumptions about the assumptions market participants would utilize in pricing the asset or liability. Valuation techniques utilized to determine fair value are consistently applied.

L. Advertising

The Bank expenses advertising costs as incurred.

M. Reclassifications

Certain reclassifications have been made to the 2007 financial statements to conform to the 2008 financial statement presentation. These reclassifications had no effect on net income.

INDEPENDENCE BANK, N.A.  
 NOTES TO FINANCIAL STATEMENTS  
 DECEMBER 31, 2008 AND 2007

NOTE 2 – RESTRICTIONS ON CASH

The Bank is required to maintain reserve funds in cash or on deposit with the Federal Reserve Bank. The reserve required at December 31, 2008 was \$476,000.

NOTE 3 – DEBT AND EQUITY SECURITIES

Debt and equity securities have been classified in the balance sheets according to management's intent at December 31, 2008 and 2007. The Bank has one security valued as a Level 3 fair value, as noted below. All other securities are considered Level 2 fair values. The carrying amount of securities and their approximate fair values at December 31 were as follows:

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
<b>Available-for-Sale Securities:</b>				
<b>December 31, 2008</b>				
U.S. Government				
Agency securities	\$ 8,496,282	\$ 15,748	\$ -	\$ 8,512,030
Mortgage-backed securities	970,153	1,935	(12,520)	959,568
Municipal securities	20,543,037	312,006	-	20,855,043
Equity securities	<u>1,971,944</u>	<u>35,556</u>	<u>-</u>	<u>2,007,500</u>
<b>TOTALS</b>	<b><u>\$ 31,981,416</u></b>	<b><u>\$ 365,245</u></b>	<b><u>\$ (12,520)</u></b>	<b><u>\$ 32,334,141</u></b>

Available-for-Sale Securities:

<b>December 31, 2007</b>				
U.S. Government				
agency securities	\$ 32,656,004	\$ 38,469	\$ (36,309)	\$ 32,658,164
Mortgage-backed securities	<u>3,057,139</u>	<u>1,698</u>	<u>(10,218)</u>	<u>3,048,619</u>
<b>TOTALS</b>	<b><u>\$ 35,713,143</u></b>	<b><u>\$ 40,167</u></b>	<b><u>\$ (46,527)</u></b>	<b><u>\$ 35,706,783</u></b>

For the years ended December 31, 2008 and 2007, proceeds from the sale of available-for-sale securities were \$42,328,157 and \$2,300,158, respectively. The sales resulted in net gains of \$247,988 and \$8,209, respectively.

INDEPENDENCE BANK, N.A.  
 NOTES TO FINANCIAL STATEMENTS  
 DECEMBER 31, 2008 AND 2007

NOTE 3 – DEBT AND EQUITY SECURITIES (CONTINUED)

Assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3):

	<u>Municipal Securities</u>
January 1, 2008	\$ -
Total gains or losses (realized or unrealized)	-
Purchases	3,000,000
Transfers in and/or out of Level 3	<u>-</u>
December 31, 2008	<u>\$ 3,000,000</u>

These assets have been valued using a market approach.

Securities in an unrealized loss position at December 31, 2008 are summarized below as to whether the security has been in a loss position for less than twelve (12) months or more than twelve (12) months:

Description of Securities	<u>December 31, 2008</u>				<u>Total</u>	
	<u>Less Than Twelve Months</u>		<u>Twelve Months or More</u>		<u>Fair Value</u>	<u>Unrealized Losses</u>
	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>		
Mortgage-backed securities	\$ 714,653	\$ (12,520)	\$ -	\$ -	\$ 714,653	\$ (12,520)
TOTAL TEMPORARILY IMPAIRED SECURITIES	<u>\$ 714,653</u>	<u>\$ (12,520)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 714,653</u>	<u>\$ (12,520)</u>

The unrealized losses on the Bank's investments are due primarily to interest rate fluctuations during 2008. Because the Bank has the ability and intent to hold these investments until a recovery of fair value, which may be maturity, and that the decline in market value is due to interest rates and not credit quality, the Bank does not consider these investments to be other-than-temporarily impaired at December 31, 2008.

INDEPENDENCE BANK, N.A.  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2008 AND 2007

NOTE 3 – DEBT AND EQUITY SECURITIES (CONTINUED)

The scheduled maturities of securities available-for-sale at December 31, 2008 were as follows:

	<u>Available-for-Sale Securities</u>	
	<u>Amortized Cost</u>	<u>Fair Value</u>
Due in one year or less	\$ 403,577	\$ 404,428
Due from one year to five years	83,219	84,248
Due from five to ten years	8,467,255	8,518,370
Due after ten years	<u>23,027,365</u>	<u>23,327,095</u>
<b>TOTALS</b>	<b><u>\$ 31,981,416</u></b>	<b><u>\$ 32,334,141</u></b>

For purposes of the maturity table, mortgage-backed securities, which are not due at a single maturity date, have been allocated over maturity groupings based on the actual contractual maturities of underlying collateral. The mortgage-backed securities may mature earlier than their actual contractual maturities because of principal prepayments.

NOTE 4 – LOANS RECEIVABLE

The components of loans receivable in the balance sheets were as follows:

	<u>2008</u>	<u>Percent</u>	<u>2007</u>	<u>Percent</u>
Commercial	\$ 42,581,905	52.3%	\$ 41,452,914	52.6%
Real estate	48,972,978	45.4%	34,724,061	44.0%
Consumer and installment	<u>2,127,961</u>	<u>2.3%</u>	<u>2,703,081</u>	<u>3.4%</u>
Total Loans	<b>93,682,844</b>	<b><u>100.0%</u></b>	78,880,056	<u>100.0%</u>
Less: unamortized loan fees	(55,673)		(23,528)	
Less: allowance for loan losses	<u>(1,284,859)</u>		<u>(920,792)</u>	
<b>NET LOANS</b>	<b><u>\$ 92,342,312</u></b>		<b><u>\$ 77,935,736</u></b>	

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NOTE 4 – LOANS RECEIVABLE (CONTINUED)

An analysis of the change in the allowance for loan losses follows:

	<u>2008</u>	<u>2007</u>
BALANCE AT JANUARY 1	<u>\$ 920,792</u>	<u>\$ 899,927</u>
Loans charged off	(31,933)	(53,212)
Recoveries	<u>-</u>	<u>8,077</u>
Net loans charged off	<u>(31,933)</u>	<u>(45,135)</u>
Provision for loan losses	<u>396,000</u>	<u>66,000</u>
BALANCE AT DECEMBER 31	<u>\$ 1,284,859</u>	<u>\$ 920,792</u>

An analysis of the loan portfolio and other assets at December 31 follows:

	<u>2008</u>	<u>2007</u>
Loans that are ninety days or more past due and still accruing interest	\$ 866,892	\$ 256,533
Loans whose accrual of interest had been discontinued	\$ -	\$ -
Foreclosed and repossessed assets other than real estate	\$ -	\$ -
Overdraft balances classified as loans	\$ 1,572	\$ 33,640

NOTE 5 – LONG-TERM INVESTMENT

Federal Reserve Bank, Federal Home Loan Bank and The Independent Bankers Bank stock are required investments for institutions that are members of the Federal Reserve Bank, Federal Home Loan Bank, and The Independent Bankers Bank systems. The required investment in the common stock is based on a predetermined formula. As of December 31, 2008, the Bank holds \$220,400, \$437,900, and \$75,000, respectively.

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NOTE 6 – OTHER REAL ESTATE

An analysis of the change in other real estate follows:

	<u>2008</u>	<u>2007</u>
Balance at January 1	\$ 380,013	\$ -
Foreclosures and additions	317,607	436,710
Impairments	-	(20,000)
Sales, net of gains and losses	<u>(697,620)</u>	<u>(36,697)</u>
 OUTSTANDING AT DECEMBER 31	 <u>\$ -</u>	 <u>\$ 380,013</u>

The Bank recognized a gain of \$28,399 and \$-0- on sale of property as of December 31, 2008 and 2007, respectively.

NOTE 7 – PREMISES AND EQUIPMENT

Components of premises and equipment included in the balance sheets at December 31, 2008 and 2007 were as follows:

	<u>2008</u>	<u>2007</u>
Cost:		
Leasehold improvements	\$ 1,296,888	\$ 1,296,455
Furniture, fixtures and equipment	<u>1,514,222</u>	<u>1,414,657</u>
Total cost	2,811,110	2,711,112
Less: accumulated depreciation	<u>(1,804,594)</u>	<u>(1,504,271)</u>
 NET BOOK VALUE	 <u>\$ 1,006,516</u>	 <u>\$ 1,206,841</u>

Depreciation expense was \$330,649 and \$321,928 as of December 31, 2008 and 2007, respectively.

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NOTE 8 – MATURITIES OF TIME DEPOSITS

Following are maturities of time deposits at December 31, 2008:

<u>For the Year Ending</u> <u>December 31,</u>	<u>Amount</u>
2009	\$ 61,543,013
2010	3,366,749
2011	2,814,455
2012	2,683,077
2013	25,668
Thereafter	<u>-</u>
<b>TOTAL</b>	<b><u>\$ 70,432,962</u></b>

At December 31, 2008 and 2007, the Bank had approximately \$35,941,466 and \$29,200,000, respectively, in time deposits \$100,000 and over. At December 31, 2008, all except \$4,855,742 mature within one (1) year.

Interest expense on time certificates of deposit and other time deposits in denominations of \$100,000 or more amounted to approximately \$1,035,000 and \$1,283,000 for the years ended December 31, 2008 and 2007, respectively.

NOTE 9 – FINANCIAL INSTRUMENTS WITH OFF-BALANCE-SHEET RISK

In the normal course of business, the Bank has outstanding commitments to extend credit and standby letters of credit, which are not included in the accompanying financial statements. The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instruments for commitments to extend credit and standby letters of credit is represented by the contractual or notional amount of those instruments. The Bank uses the same credit policies in making commitments as it does for instruments that are included in the balance sheets.

Financial instruments whose contract amounts represent off-balance-sheet credit risk are as follows:

	<b><u>Contract</u></b> <b><u>Amount</u></b> <b><u>2008</u></b>	<b><u>Contract</u></b> <b><u>Amount</u></b> <b><u>2007</u></b>
COMMITMENTS TO EXTEND CREDIT	<b><u>\$ 16,838,866</u></b>	<b><u>\$ 16,258,797</u></b>
STANDBY LETTERS OF CREDIT	<b><u>\$ 183,800</u></b>	<b><u>\$ 567,001</u></b>

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NOTE 9 – FINANCIAL INSTRUMENTS WITH OFF-BALANCE-SHEET RISK (CONTINUED)

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

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Standby letters of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank's policy for obtaining collateral, and the nature of such collateral, is essentially the same as that involved in making commitments to extend credit.

NOTE 10 – LEASES

The Bank has noncancelable operating leases that expire over the next six (6) years that require the payment of base lease amounts and executory costs such as taxes, maintenance and insurance. Rental expense for these leases was approximately \$415,000 and \$394,000 for the years ended December 31, 2008 and 2007, respectively.

Approximate future minimum rental commitments under noncancelable leases are:

<u>For the Year Ending</u> <u>December 31,</u>	<u>Amount</u>
2009	\$ 390,000
2010	396,000
2011	340,000
2012	340,000
2013	<u>207,000</u>
TOTAL	<u>\$ 1,673,000</u>

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NOTE 11 – 401(k) PLAN

Effective January 1, 2002, the Bank adopted an employee savings plan. The plan covers all full-time employees who have met certain service and age requirements. Employees may designate a portion of their salary to be contributed to the Plan on a tax deferred basis. In addition, the Bank may make discretionary matching and profit sharing contributions in an amount determined by the Board of Directors. The Bank made matching contributions of \$67,683 and \$63,033 for the years ended December 31, 2008 and 2007, respectively.

NOTE 12 – INCOME TAXES

The provision for income taxes includes these components:

	<u>2008</u>	<u>2007</u>
Taxes currently payable	\$ -	\$ -
Deferred income tax expense (benefit)	<u>67,627</u>	<u>(319,565)</u>
<b>INCOME TAX EXPENSE (BENEFIT)</b>	<u><b>\$ 67,627</b></u>	<u><b>\$ (319,565)</b></u>

A reconciliation of income tax expense at the statutory rate to the Bank's actual income tax expense is shown below:

	<u>2008</u>	<u>2007</u>
Computed at the statutory rate (34%)	\$ 79,688	\$ 138,461
Increase (decrease) resulting from:		
Temporary differences and other	(12,061)	(46,530)
Changes in the deferred tax asset valuation allowance	<u>-</u>	<u>(411,496)</u>
<b>ACTUAL TAX EXPENSE (BENEFIT)</b>	<u><b>\$ 67,627</b></u>	<u><b>\$ (319,565)</b></u>

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NOTE 12 – INCOME TAXES (CONTINUED)

The tax effects of temporary differences related to deferred taxes shown on the balance sheets were:

	<u>2008</u>	<u>2007</u>
Deferred tax assets		
Allowance for loan losses	\$ 304,876	\$ 181,093
Unrealized losses on available-for-sale securities	-	2,163
Deferred loan fees	18,929	7,999
Depreciation and amortization	112,183	72,639
Net operating loss carryforwards and tax credits	247,681	542,948
Deferred tax liabilities		
Unrealized gains on available-for-sale securities	(119,927)	-
Section 481: accrual to cash conversion	<u>(106,769)</u>	<u>(160,153)</u>
Net Deferred Tax Assets Before Valuation Allowance	<u>456,973</u>	<u>646,689</u>
Valuation allowance		
Beginning balance	-	(411,496)
(Increase) decrease during the period	<u>-</u>	<u>411,496</u>
Ending Balance	<u>-</u>	<u>-</u>
NET DEFERRED TAX ASSET	<u>\$ 456,973</u>	<u>\$ 646,689</u>

As of December 31, 2008, the Bank had approximately \$640,000 of net operating loss carryforwards available to offset future federal income taxes which will begin expiring in 2022.

NOTE 13 – COMMITMENTS AND CONTINGENT LIABILITIES

In the ordinary course of business, the Bank may have various outstanding commitments and contingent liabilities. As of December 31, 2008 and 2007, management was not aware of any material commitments or contingent liabilities requiring accrual or disclosure.

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NOTE 14 – OTHER COMPREHENSIVE INCOME

Other comprehensive income components and related taxes were as follows:

	<u>2008</u>	<u>2007</u>
Unrealized gains on available-for-sale securities:		
Changes in fair value of available-for-sale securities arising during the period	\$ 356,669	\$ 183,859
Reclassification adjustment for previously unrealized gains included in income	<u>2,416</u>	<u>29,251</u>
Other comprehensive income, before tax effect	359,085	213,110
Tax expense	<u>(122,089)</u>	<u>(72,457)</u>
OTHER COMPREHENSIVE INCOME	<u>\$ 236,996</u>	<u>\$ 140,653</u>

NOTE 15 – REGULATORY MATTERS

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 regulators, that if undertaken, could have a direct material effect on the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines involving quantitative measures of the Bank's assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of total risk-based capital and Tier 1 capital to risk-weighted assets, and Tier 1 capital to adjusted total assets. Management believes, as of December 31, 2008, that the Bank meets all capital adequacy requirements to which it is subject.

The Bank is also subject to certain restrictions on the amount of dividends that they may declare without prior regulatory approval.

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**NOTE 15 – REGULATORY MATTERS (CONTINUED)**

As of December 31, 2008, the Bank was categorized as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank will have to maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as disclosed in the table below. There are no conditions or events that management believes have changed the Bank's prompt corrective action category.

The Bank's actual and required capital amounts and ratios are as follows:

	<u>Actual</u>		<u>For Capital Adequacy Purposes:</u>		<u>To Be Well Capitalized Under Prompt Corrective Action Provisions:</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
<b>As of December 31, 2008:</b>						
(in thousands)						
Total Capital (to Risk-Weighted Assets)	\$ 15,785	14.70%	\$ 8,591	≥8.00%	\$ 10,739	≥10.00%
Tier I Capital (to Risk-Weighted Assets)	\$ 14,741	13.73%	\$ 4,295	≥4.00%	\$ 6,443	≥6.00%
Tier I Capital (to Average Assets)	\$ 14,741	11.07%	\$ 5,326	≥4.00%	\$ 6,658	≥5.00%
<b>As of December 31, 2007:</b>						
(in thousands)						
Total Capital (to Risk-Weighted Assets)	\$ 15,221	16.69%	\$ 7,295	≥8.00%	\$ 9,119	≥10.00%
Tier I Capital (to Risk-Weighted Assets)	\$ 14,301	15.68%	\$ 3,647	≥4.00%	\$ 5,471	≥6.00%
Tier I Capital (to Average Assets)	\$ 14,301	10.64%	\$ 5,378	≥4.00%	\$ 6,722	≥5.00%

**NOTE 16 – RELATED PARTY TRANSACTIONS**

The Bank has entered into transactions with its executive officers, Directors, significant stockholder, and their affiliates (related parties). Fees and bonuses paid to Directors during 2008 and 2007 totaled \$33,500 and \$38,500, respectively. Deposits from related parties held by the Bank at December 31, 2008 and 2007 amounted to \$12,450,645 and \$18,078,000, respectively. The aggregate amount of loans to such related parties is as follows:

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NOTE 16 – RELATED PARTY TRANSACTIONS (CONTINUED)

	<u>2008</u>	<u>2007</u>
Outstanding at January 1	\$ 927,643	\$ 1,642,732
New loans	319,000	-
Repayments	(52,552)	(760,184)
Credit line activity (net)	<u>-</u>	<u>45,095</u>
 LOANS OUTSTANDING AT DECEMBER 31	 <u>\$ 1,194,091</u>	 <u>\$ 927,643</u>

In management’s opinion, such loans and other extensions of credit and deposits were made in the ordinary course of business and were made on substantially the same terms (including interest rates and collateral) as those prevailing at the time for comparable transactions with other persons. Further, in management’s opinion, these loans did not involve more than normal risk of collectability or present other unfavorable features.

Included in real estate loans are participations purchased through the Bank’s loan participation program with First Continental Investment Co., Ltd. (FCIC) totaling approximately \$-0- and \$782,000 at December 31, 2008 and 2007, respectively. FCIC is a private mortgage company that provides financing to experienced land developers. A Bank director is the President of FCIC and the Bank’s Chairman of the Board and one Director are partners in FCIC. Management requires that loan participations purchased under this program undergo an independent internal evaluation of the creditworthiness of the borrower, the value of the collateral, and the adequacy of the associated documentation on the loan prior to acquisition. At December 31, 2008, the Bank had no unfunded commitments to FCIC.

NOTE 17 – STOCK OPTION PLAN

The Bank’s Employee Share Option Plan (the “Plan”) which is stockholder approved, permits the grant of share options and shares to its employees for up to 500,000 shares of common stock. However, the compensation committee has limited the number of authorized shares for options to fifteen percent (15%) of outstanding shares plus shares authorized for stock options. At December 31, 2008 and 2007, there were 279,311 shares authorized for stock options. The Bank believes that such awards better align the interests of its employees with those of its stockholders. Option awards are generally granted with an exercise price equal to the market price of the Bank’s stock at the date of grant; those option awards generally vest based on two (2), four (4) or five (5) years of continuous service and have ten-year contractual terms. Certain option and share awards provide for accelerated vesting if there is a change in control (as defined in the Plan).

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NOTE 17 – STOCK OPTION PLAN (CONTINUED)

The fair value of each option award is estimated on the date of grant using a binomial option valuation model that uses the assumptions noted in the following table. Expected volatility is based on historical volatility of the Bank’s stock and other factors. The Bank uses historical data to estimate option exercise and employee termination within the valuation model; separate groups of employees that have similar historical exercise behavior are considered separately for valuation purposes. The expected term of options granted is derived from the output of the option valuation model and represents the period of time that options granted are expected to be outstanding; the range given below results from certain groups of employees exhibiting different behavior. The risk-free rate for periods within the contractual life of the option is based on the Federal Funds discount rate in effect at the time of grant.

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Expected volatility	<b>10%</b>	10%	10%
Expected dividends	<b>-0-%</b>	-0-%	-0-%
Expected term (in years)	<b>10</b>	10	10
Risk-free rate	<b>2.00% - 4.25%</b>	4.25% - 5.25%	4.50% - 4.75%

A summary of option activity under the Plan as of December 31, 2008, and changes during the year then ended, is presented below:

	<u>2008</u>		
	<u>Shares</u>	<u>Weighted- Average Exercise Price</u>	<u>Weighted- Average Remaining Contractual Term</u>
Outstanding, beginning of year	267,637	\$ 10.83	7.65
Granted	8,000	\$ 12.00	9.29
Exercised	-	\$ -	-
Forfeited or expired	<u>(9,600)</u>	\$ 11.97	8.61
<b>OUTSTANDING, END OF YEAR</b>	<u><u>266,037</u></u>	\$ 10.83	<u><u>6.72</u></u>
<b>EXERCISABLE, END OF YEAR</b>	<u><u>130,337</u></u>	\$ 10.16	<u><u>5.60</u></u>

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NOTE 17 – STOCK OPTION PLAN (CONTINUED)

The weighted-average grant-date fair value of options granted during the years 2008, 2007 and 2006 was \$4.35, \$4.35 and \$3.54, respectively.

A summary of the status of the Bank’s nonvested shares as of December 31, 2008, and changes during the year ended December 31, 2008, is presented below:

	<u>Shares</u>	<u>Weighted- Average Grant- Date Fair Value</u>
Nonvested, beginning of year	181,800	\$ 4.01
Granted	8,000	\$ 2.84
Vested	(44,600)	\$ 3.55
Forfeited	<u>(9,500)</u>	\$ 4.45
 NONVESTED, END OF YEAR	 <u><u>135,700</u></u>	 \$ 4.11

As of December 31, 2008, there was approximately \$454,000 of total unrecognized compensation cost related to nonvested share-based compensation arrangements granted under the Plan. That cost is expected to be recognized over a weighted-average period of 3.18 years. The total fair value of shares vested during the years ended December 31, 2008, 2007 and 2006, was \$167,000, \$79,000 and \$78,000, respectively. The Bank recorded \$107,765 of compensation expense related to these options during 2008.

As remuneration for advances and services provided by the organizing Directors and officers, the Bank issued a total of 45,000 warrants to acquire shares of Bank common stock. Each warrant entitles the holder to acquire one share of the Bank’s common stock at a price of \$10.00 per share (the initial offering price) for a period of ten (10) years following the date of issuance. These warrants may be exercised at any time. At December 31, 2008 and 2007, 45,000 warrants remained outstanding.

NOTE 18 – FAIR VALUES OF FINANCIAL INSTRUMENTS

The following table presents estimated fair values of the Bank’s financial instruments. The fair values of certain of these instruments were calculated by discounting expected cash flows, which involves significant judgments by management and uncertainties. Fair value is the estimated amount at which financial assets or liabilities could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Because no market exists for certain of these financial instruments and because management does not intend to sell these financial instruments, the Bank does not know whether the fair values shown below represent values at which the respective financial instruments could be sold individually or in the aggregate.

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NOTE 18 – FAIR VALUES OF FINANCIAL INSTRUMENTS (CONTINUED)

	<b>December 31, 2008</b>		December 31, 2007	
	<u>Carrying Amount</u>	<u>Fair Value</u>	<u>Carrying Amount</u>	<u>Fair Value</u>
Financial assets:				
Cash and cash equivalents	\$ 8,806	\$ 8,806	\$ 15,467	\$ 15,467
Money market securities	1,000	1,001	5,000	4,997
Available-for-sale securities	32,334	32,334	35,707	35,707
Loans, net of allowance for loan losses	92,342	95,081	77,936	78,136
Federal Reserve, Federal Home Loan and TIB Bank stock	733	733	712	712
Financial liabilities:				
Demand deposits	21,415	21,415	20,209	20,209
Checking and savings	31,044	31,044	55,300	55,330
Time deposits	70,433	71,432	48,131	48,587

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

Cash and Cash Equivalents, Interest-bearing Deposits and Federal Reserve, Federal Home Loan and The Independent Bankers (TIB) Bank Stock

The carrying amount approximates fair value.

Securities

Fair values equal quoted market prices, if available. If quoted market prices are not available, fair value is estimated based on quoted market prices of similar securities.

NOTE 18 – FAIR VALUES OF FINANCIAL INSTRUMENTS (CONTINUED)

Loans

The fair value of loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. Loans with similar characteristics were aggregated for purposes of the calculations. The carrying amount of accrued interest approximates its fair value.

Deposits

Deposits include demand deposits, savings accounts, NOW accounts and certain money market deposits. The carrying amount approximates fair value. The fair value of fixed-maturity time deposits is estimated using a discounted cash flow calculation that applies the rates currently offered for deposits of similar remaining maturities.

Interest Payable

The carrying amount approximates fair value.

Commitments to Originate Loans and Letters of Credit

The fair value of commitments to originate loans is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates. The fair values of letters of credit and lines of credit are based on fees currently charged for similar agreements or on the estimated cost to terminate or otherwise settle the obligations with the counterparties at the reporting date.