2013 Annual Report

SANTA CRUZ COUNTY BANK

Celebrating 10 Years

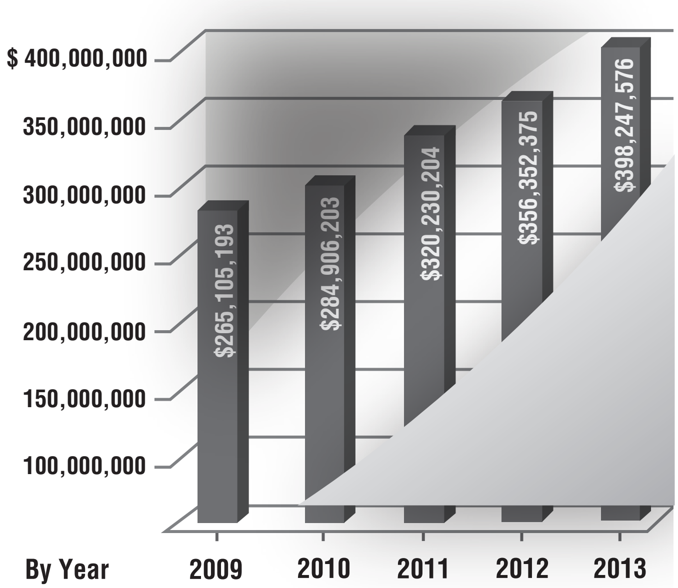
ABOUT SANTA CRUZ COUNTY BANK

Founded by a group of local business people who share a common commitment to the Santa Cruz area, Santa Cruz County Bank first opened its doors on February 3, 2004. Santa Cruz County Bank is a locally owned and operated community bank, serving the needs of the residents and businesses of Santa Cruz County. We believe strongly in the importance of local decision making and responsive customer service. We offer a complete line of depository products and lending solutions for businesses and individuals, including business term loans and lines of credit, commercial real estate financing, agricultural loans, SBA and USDA government guaranteed loans, credit cards, merchant services, remote deposit capture, and online services, including bill payment and cash management. Santa Cruz County Bank operates five full service banking offices located in Aptos, Capitola, Santa Cruz, Scotts Valley, and Watsonville, and two free standing ATM and Night Depositories in Santa Cruz and Aptos.

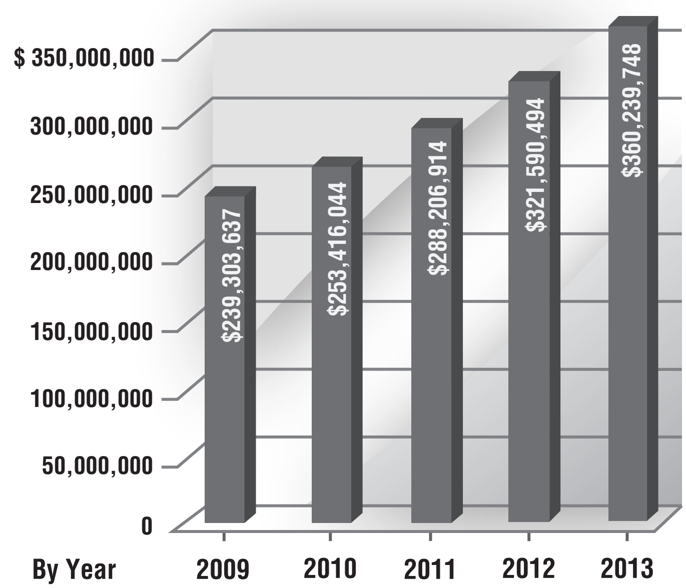
"We are grateful to our community, our shareholders, our board members and our dedicated employees for their unending support and commitment to building an exceptional bank."

— David Heald, President and CEO

TOTAL ASSETS



TOTAL DEPOSITS



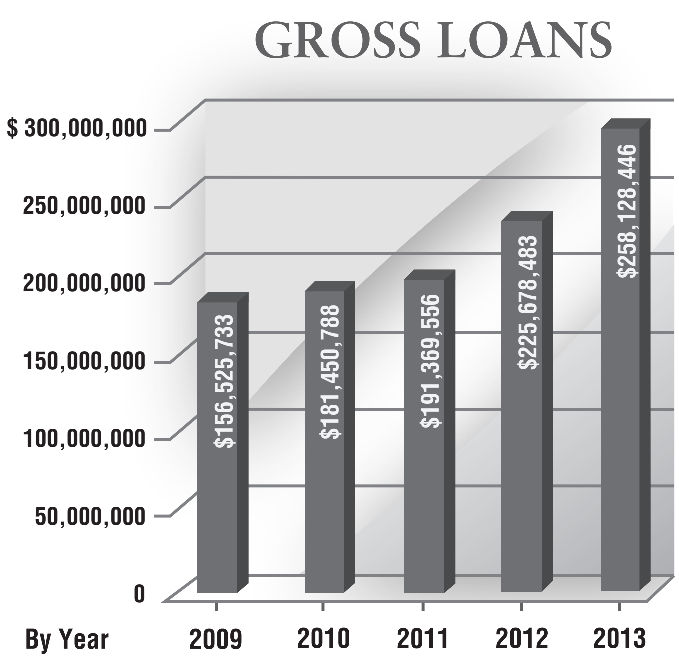
SHAREHOLDER INFORMATION

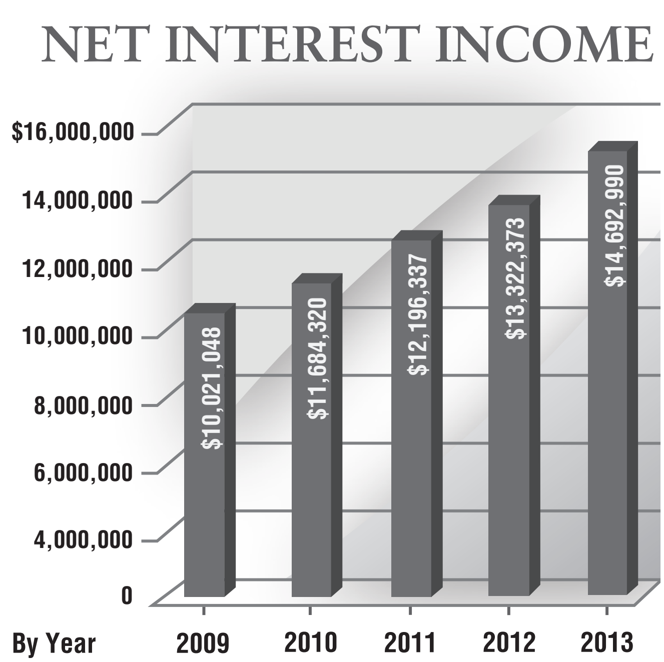
Santa Cruz County Bank's common stock is listed on the Over the Counter Bulletin Board as SCZC. Shareholders with questions regarding their stockholder account, stock transfer and registration, lost certificates or change of address should contact their broker, or if held directly, contact the Bank's stock transfer agent listed below:

Computershare Investor Services, 350 Indiana St., Ste. 800, Golden, CO 80401

800.962.4284, www.computershare.com

Santa Cruz County Bank ranked 103rd in American Banker magazine's top performing 200 community banks and thrifts in the United States. A total of 851 institutions, with less than $2 billion in assets, were included in the nationwide ranking. Ranking was based upon 3-year average return on equity for the years ending December 31, 2010, 2011 and 2012.





Historic Milestones

Ten Years of Growth

2004

February 2004
Santa Cruz office opens

November 2004
Scotts Valley office opens

February 2005
Watsonville office opens

November 2005
Self Service ATM / Night Depository opens at Dominican Hospital in Santa Cruz

December 2005
Self Service ATM / Night Depository opens at Deluxe Foods of Aptos

June 2007
Capitola office opens

July 2008
Santa Cruz office relocates to 720 Front Street

February 2009
Aptos office opens

Ten Years of Success

2005

March 2005
Achieved SBA "Preferred Lender" status

September 2005
Announced quarterly profitability

2006

December 2006
Designated "Premier" Performer as a De Novo Bank

2007

June 2007
Achieved profitability on a cumulative basis

2008

2009

2010

2011

December 2010
Designated as a "Super Premier" Performing Bank

December 2011
Designated as a "Super Premier" Performing Bank

2012

December 2012
Designated as a "Super Premier" Performing Bank

2012
Designated one of eleven "Exceptional Banks" in California

2013

2013
Voted "Best Bank" in Santa Cruz County

2013
Business "Be The Difference" Award for Volunteerism & Leadership

May 2013
Declared first cash dividend to shareholders

May 2013
Ranked in the Top 200 Community Banks in the United States

December 2013
Designated as a "Super Premier" Performing Bank

2014

February 2014
Celebrated 10 years serving Santa Cruz County

SANTA CRUZ COUNTY BANK
Letter to Shareholders

To Our Shareholders,

On behalf of the Board of Directors and Management team, we are pleased to present our Annual Report and highlights for 2013.

Our ongoing commitment to sound fiscal management, maintaining credit quality and increasing shareholder value combined to produce record financial performance in 2013. Santa Cruz County Bank achieved record earnings for the year ended December 31, 2013, with a 17% increase in net income and double digit percentage growth in assets, loans, and deposits over the 2012 operating year.

The Bank's continued positive financial performance has resulted in a year over year increase in the value of your investment. In 2013, our Board of Directors declared three cash dividends to shareholders. Shareholders' equity increased $2.9 million to $32.8 million, a 10% improvement over the prior year. In addition, the book value of Santa Cruz County Bank's common stock increased from $15.16 on December 31, 2012 to $16.39 per share at December 31, 2013. Comparing the same periods, basic earnings per share increased from $1.47 to $1.68, a 14% increase over the prior year.

While maintaining a fine balance between growth and preservation of credit quality in our loan portfolio we produced a $32 million, 14%, increase in total gross loans to $258 million for the year ended 2013 as compared to $226 million for the year ended 2012. Total non-performing loans registered at a low of 0.17% of total assets. For the seventh consecutive year, the Bank has been recognized as the top SBA 7a and 504 lender in Santa Cruz County. Moreover, Santa Cruz County Bank ranked 37th statewide in SBA lending for the 2013 fiscal year. Our reputation as a top lender boosts our ability to gain new business and help more businesses expand their operations.

continued next page

2013 HIGHLIGHTS

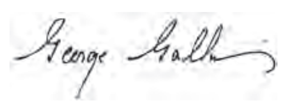
- ***Total assets surpassed $398 million.***
- ***Total deposits surpassed $360 million.***
- ***Net income before tax exceeded $5 million.***
- ***The Board of Directors declared three $0.05 cash dividends to shareholders.***
- ***Santa Cruz County Bank remained as top SBA lender in Santa Cruz County and ranked 37th statewide for the 2013 SBA fiscal year.***
- ***As of June 30, 2013, the Bank ranked fifth largest in overall market share, increasing to 7.77% of deposits held by FDIC insured institutions in Santa Cruz County.***
- ***The Bank was designated a "Super Premier" Performing Bank by Findley Reports for its 2013 performance.***
- ***The Bank received 4-Star "Excellent" ratings by Bauer Financial Inc. for its quarterly financial performance in 2013.***
- ***The Bank received the 2013 Volunteer Center of Santa Cruz County "Be the Difference" Business Award for its leadership and volunteer efforts.***
- ***Santa Cruz County Bank was voted "Best Bank" in Santa Cruz County in the Good Times readers poll.***

Effective execution of our strategic plan year after year has resulted in the delivery of exceptional financial performance for the past decade. Our financial performance has earned us notable ratings and recognition in our industry. Most significant in 2013 was our Bank being ranked in American Banker magazine's "Top Performing 200 Community Banks and Thrifts in the United States" based upon three-year average return on equity. The Bank placed 103rd out of 851 institutions in the nation. In addition, Santa Cruz County Bank was designated as a "Super Premier" Performing Bank by the Findley Reports for the fourth consecutive year. Other recognitions and awards are included in the 2013 highlights section on page three.

We are proud to be an active partner in our community and to be recognized by our community. We remain dedicated to customer service and community well-being and believe these qualities set us apart and enable us to build enduring partnerships with the individuals, businesses and organizations that make up the fabric of our community. Their success is our success.

As we enter into our eleventh year of operations, we continue to invest in new product delivery systems to meet the financial needs of our customers. Recently, we launched new technology that will enable us to serve our customers' needs and optimize their banking experience well into the next decade.

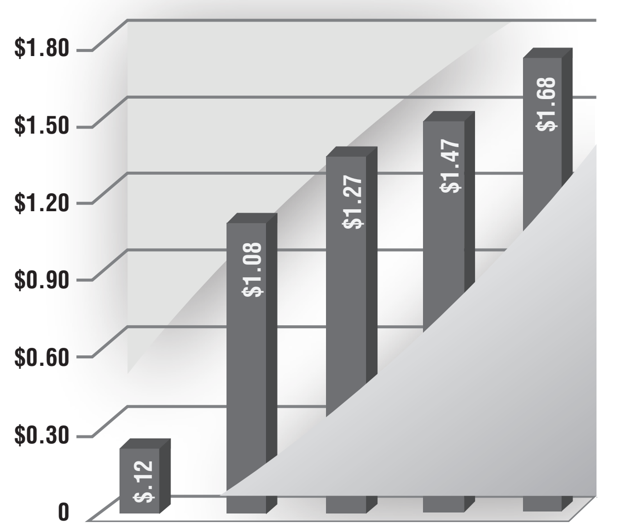
As always, we remain grateful for your immeasurable support of Santa Cruz County Bank and our mission to be the local community bank of choice.



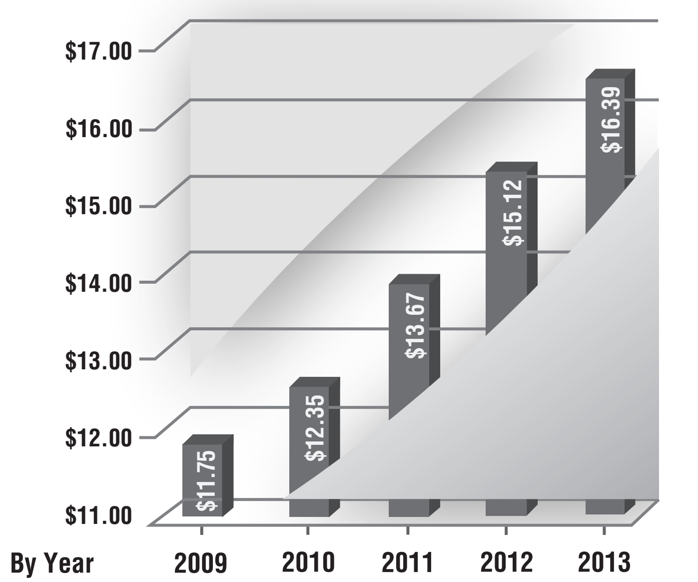
George Gallucci
Chairman
of the Board

David Heald
President &
Chief Executive Officer

EARNINGS PER SHARE



BOOK VALUE PER SHARE



Crowe Horwath.

Crowe Horwath LLP
Independent Member Crowe Horwath International

INDEPENDENT AUDITOR'S REPORT

The Shareholders and Board of Directors
Santa Cruz County Bank
Santa Cruz, California

Report on the Financial Statements

We have audited the accompanying financial statements of Santa Cruz County Bank (the "Bank"), which comprise the balance sheets as of December 31, 2013 and 2012, and the related statements of income, comprehensive income, changes in shareholders' 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 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 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 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the 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 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 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 financial statements referred to above present fairly, in all material respects, the financial position of Santa Cruz County Bank as of December 31, 2013 and 2012, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Crowe Horwath LLP

Crowe Horwath LLP

San Francisco, California
March 21, 2014

SANTA CRUZ COUNTY BANK
Balance Sheets
December 31, 2013 and 2012

	2013	2012
ASSETS		
Cash and due from financial institutions	$ 10,780,052	$ 11,471,964
Federal funds sold	1,350,967	896,256
Cash and cash equivalents	12,131,019	12,368,220
Interest-bearing deposits in other financial institutions	66,715,534	67,676,997
Securities available for sale	-	39,132,187
Securities held to maturity (Fair Value 2013 $53,387,617; 2012 $186,974)	53,266,005	176,866
Loans held for sale	23,716,079	19,835,664
Loans receivable, net of allowance of $5,705,862 and $5,048,577	229,267,807	200,993,664
Federal Home Loan Bank stock, at cost	1,184,300	1,076,500
Pacific Coast Bankers Bank stock, at cost	170,000	170,000
Real estate owned, net	358,584	3,166,000
Premises and equipment, net	839,016	1,164,354
Bank owned life insurance	5,380,629	5,207,265
Deferred income tax	3,236,257	2,563,247
Accrued interest receivable	1,312,772	1,190,766
Other assets	1,000,082	1,630,645
TOTAL ASSETS	$ 398,578,084	$ 356,352,375
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits		
Non-interest bearing	$ 166,021,518	$ 139,694,792
Interest bearing	194,218,230	181,895,702
Total deposits	360,239,748	321,590,494
Accrued interest payable	89,049	89,616
Other liabilities	5,472,983	4,822,291
Total liabilities	365,801,780	326,502,401
Commitments and contingent liabilities		
Shareholders' equity		
Preferred stock, no par value; 10,000,000 shares authorized; no shares issued or outstanding		
Common stock, no par value; 30,000,000 shares authorized; 1,999,090 shares issued at December 31, 2013 and 1,966,940 shares issued at December 31, 2012	21,904,069	21,573,659
Additional paid-in capital	959,232	868,559
Retained earnings	10,423,089	7,406,722
Accumulated other comprehensive (loss) income	(510,086)	1,034
Total shareholders' equity	32,776,304	29,849,974
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 398,578,084	$ 356,352,375

SANTA CRUZ COUNTY BANK
Statements of Income
Years ended December 31,

	2013	2012
Interest and dividend income		
Loans, including fees	$ 13,385,589	$ 11,960,410
Interest-bearing deposits in other financial institutions	728,073	810,576
Taxable securities	603,266	622,520
Tax exempt securities	372,538	372,690
Federal funds sold	17,290	16,844
Total interest and dividend income	15,106,756	13,783,040
Interest expense		
Deposits	413,493	460,181
Federal Home Loan Bank advances and federal funds purchased	273	486
Total interest expense	413,766	460,667
Net interest income	14,692,990	13,322,373
Provision for loan losses	487,500	994,000
Net interest income after provision for loan losses	14,205,490	12,328,373
Noninterest income		
Service charges on deposits	700,445	721,466
Net gains on sales of loans	1,097,391	950,757
Loan servicing fees	396,135	304,965
Net gains on sales of securities	31,781	2,039
Other	1,104,198	879,665
Total noninterest income	3,329,950	2,858,892
Noninterest expense		
Salaries and employee benefits	6,442,206	5,944,133
Occupancy	990,585	963,361
Furniture and equipment	415,289	386,550
Marketing and business development	292,353	234,291
Data and item processing	921,797	535,073
Professional services	1,048,131	288,137
Federal deposit insurance	275,659	256,792
Provision for off balance sheet commitments	16,852	2,625
Other	2,084,059	2,021,078
Total noninterest expense	12,486,931	10,632,040
Income before income taxes	5,048,509	4,555,225
Income tax expense	1,736,512	1,714,920
Net income	$ 3,311,997	$ 2,840,305
Earnings per share:		
Basic	$ 1.68	$ 1.47
Diluted	$ 1.62	$ 1.43

SANTA CRUZ COUNTY BANK
Statements of Comprehensive Income
Years ended December 31,

	2013	2012
Net income	$ 3,311,997	$ 2,840,305
Other comprehensive (loss) income:		
Unrealized gains on securities:		
Unrealized holding (loss) gain arising during the period	(1,182,133)	543,594
Reclassification adjustment for gains included in net income	(31,781)	(2,039)
Tax effect	492,319	(222,874)
Net of tax	(721,595)	318,681
Defined benefit pension plans:		
Net gain (loss) arising during the period	349,193	(384,013)
Reclassification adjustment for amortization of prior service cost and net gain/loss included in net periodic pension cost	8,480	8,480
Tax effect	(147,198)	154,496
Net of tax	210,475	(221,037)
Total other comprehensive (loss) income	(511,120)	97,644
Comprehensive income	$ 2,800,877	$ 2,937,949

SANTA CRUZ COUNTY BANK
Statements of Changes in Shareholders' Equity
Years ended December 31,

	Shares	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive (Loss) Income	Total
Balance at January 1, 2012	1,922,940	$ 21,103,659	$ 711,578	$ 4,566,417	$ (96,610)	$ 26,285,044
Net income				2,840,305		2,840,305
Other comprehensive income					97,644	97,644
Exercise of stock options, including tax benefit	47,000	470,000	79,326			$ 549,326
Restricted stock awards and related expense	(3,000)		31,607			31,607
Share-based compensation			46,048			46,048
Balance at December 31, 2012	1,966,940	$ 21,573,659	$ 868,559	$ 7,406,722	$ 1,034	$ 29,849,974
Net income				3,311,997		3,311,997
Other comprehensive loss					(511,120)	(511,120)
Exercise of stock options, including tax benefit	32,150	330,410	(873)			329,537
Restricted stock awards and related expense			27,863			27,863
Share-based compensation			63,683			63,683
Dividends				(295,630)		(295,630)
Balance at December 31, 2013	1,999,090	$ 21,904,069	$ 959,232	$ 10,423,089	$ (510,086)	$ 32,776,304

SANTA CRUZ COUNTY BANK
Statements of Cash Flows
Years ended December 31,

	2013	2012
Cash flows from operating activities		
Net income	$ 3,311,997	$ 2,840,305
Adjustments to reconcile net income to net cash from operating activities:		
Provision for loan losses	487,500	994,000
Depreciation and amortization of premises and equipment	389,132	374,169
Net amortization of securities	1,034,514	948,435
Net loan amortization and accretion	(42,866)	164,324
Deferred income tax benefit	(315,552)	(406,351)
Net realized gain on sales of securities	(31,781)	(2,039)
Net gain on sale of loans	(1,097,391)	(950,757)
Stock based compensation expense	91,546	77,655
Earnings on bank owned life insurance	(173,364)	(170,081)
Originations of loans held for sale	(16,609,050)	(20,131,841)
Proceeds from loans held for sale	13,826,026	10,964,974
Net loss on sale/disposal of assets	1,953	998
Provision for unfunded loan commitments	16,852	2,625
Gain on sale/writedowns of OREO	(57,072)	(41,592)
Deferred benefit expense	259,478	371,272
Decrease (Increase) in deferred loan fees, net of costs	(361,880)	14,757
Net change in accrued interest receivable and other assets	(122,006)	(187,132)
(Increase) Decrease in other assets	514,658	(102,044)
Net change in accrued interest payable and other liabilities	(567)	(24,803)
Increase (Decrease) in other liabilities	732,034	449,034
Net cash from operating activities	1,854,161	(4,814,092)
Cash flows from investing activities		
Redemption of certificates of deposit in other financial institutions	38,369,645	26,564,000
Purchase of certificates of deposit in other financial institutions	(37,408,182)	(30,008,997)
Available-for-sale securities:		
Sales	607,187	850,000
Maturities, prepayments and calls	1,754,000	1,500,000
Purchases	(13,729,616)	(7,489,552)
Principal repayments on securities available for sale	5,676,576	10,442,923
Held-to-maturity securities:		
Maturities, prepayments and calls	1,395,016	120,168
Purchases	(15,210,888)	-
Principal repayments on securities held to maturity	3,325,176	-
Loan originations and payments, net	(28,734,568)	(28,098,564)
Purchases of premises and equipment	(65,747)	(249,167)
Purchases of Federal Home Loan Bank stock	(107,800)	(146,400)
Net proceeds from sales of OREO	3,354,678	3,167,643
Net cash from investing activities	(40,774,523)	(23,347,946)
Cash flows from financing activities		
Net change in deposits	38,649,254	33,383,580
Proceeds from Federal Home Loan Bank advances and other debt	20,300,000	56,656,000
Repayments on Federal Home Loan Bank advances and other debt	(20,300,000)	(58,656,000)
Cash dividends paid	(295,630)	-
Proceeds from exercise of stock options, including tax benefit	329,537	549,326
Net cash from financing activities	38,683,161	31,932,906
Net change in cash and cash equivalents	(237,201)	3,770,868
Beginning cash and cash equivalents	12,368,220	8,597,352
Ending cash and cash equivalents	$ 12,131,019	$ 12,368,220
Supplemental cash flow information		
Interest paid	$ 414,333	$ 485,470
Income taxes paid	1,910,000	1,604,000
Supplemental noncash disclosures		
Transfer from portfolio loans to loans held for sale	-	7,384,535
Transfer from loans to real estate owned	216,327	3,455,499
Loans provided for sales of real estate owned	1,300,000	275,000
Transfer of securities from available for sale to held to maturity	43,096,182	-

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

Santa Cruz County Bank, referred to as "the Bank", is a California state chartered bank which offers a full range of commercial and personal banking services to residents and businesses in Santa Cruz County, California, through its five full service offices located in Aptos, Capitola, Santa Cruz, Scotts Valley, and Watsonville. The Bank was incorporated on September 10, 2003 as Santa Cruz County Bank (In Organization) and commenced banking operations on February 3, 2004 (inception), upon receipt of final regulatory approval. The Bank is subject to regulations and undergoes periodic examinations by the California Department of Business Oversight ("CDBO") and the Federal Deposit Insurance Corporation ("FDIC"). The Bank's deposits are insured by the FDIC up to applicable limits.

The majority of the Bank's business is conducted with customers located in Santa Cruz County and adjacent counties. Its primary deposit products are checking, savings, and term certificate accounts, and its primary lending products are commercial, multi-family, agriculture, loans supported by single-family residential real estate, municipal loans, and installment loans. Portions of said loans are secured by specific items of collateral including business assets, consumer assets, and commercial and residential real estate. Bank products are also supported by various government guarantee programs. Commercial loans are expected to be repaid from cash flow from operations of businesses. There are no significant concentrations of loans to any one industry or customer. However, the customers' ability to repay their loans is dependent on the real estate and general economic conditions in the area.

Summary of Significant Accounting Policies

The accounting and reporting policies of the Bank conform to accounting principles generally accepted in the United States of America ("GAAP") and prevailing practices within the banking industry.

SUBSEQUENT EVENTS: The Bank has reviewed all events occurring from December 31, 2013 through March 21, 2014, the date the financial statements were available to be issued and no subsequent events occurred requiring accrual or disclosure.

USE OF ESTIMATES: The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions based on available information that affect the reported amounts in the financial statements and the disclosures provided, and actual results could differ. The allowance for loan losses, loan servicing rights, deferred tax assets, and fair values of financial instruments are particularly subject to change.

CASH FLOWS: For purposes of reporting cash flows, cash and cash equivalents include cash, deposits in other financial institutions with maturities fewer than 90 days, and federal funds sold. Federal funds are sold for a one day period and are highly liquid investments. Net cash flows are reported for customer loan and deposit transactions, interest bearing deposits in other financial institutions, and federal funds purchased.

INTEREST-BEARING DEPOSITS IN OTHER FINANCIAL INSTITUTIONS: Interest bearing deposits in other financial institutions mature within five years and are carried at cost.

INVESTMENT SECURITIES: Debt securities are classified as held to maturity and carried at amortized cost when management has the positive intent and ability to hold them to maturity. Debt securities are classified as available for sale when they might be sold before maturity. Equity securities with readily determinable fair values are classified as available for sale. Available for sale securities are recorded at fair value with unrealized holding gains and losses reported in other comprehensive income, net of tax. At the time of purchase, the Bank designates securities as either held to maturity or available for sale based on its investment objectives, operational needs, and intent.

The Bank transferred its entire available for sale portfolio into the held to maturity category during the third quarter of 2013. Amortization of the unrealized holding gain (loss) on the securities at the date of transfer is being amortized over the remaining life of the security as an adjustment of yield. The unamortized balance of the unrealized holding gain (loss) that existed at the date of transfer continues to be reported in the accumulated other comprehensive income account, but is amortized over the remaining life of the security as an adjustment of yield in a manner consistent with the amortization of any premium or discount, as per ASC Subtopic 320, Investments-Debt and Equity Securities.

Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized on the level-yield method without anticipating prepayments, except for mortgage backed securities where prepayments are anticipated. A new book yield is calculated each month based on the previous month's book price and the maturity date or call date, whichever returns the most conservative yield. After any pro rata amortization or accretion is taken due to the current paydown amount, the difference between the beginning book value and ending book value is the month-to-date amortization/accretion.

For collateralized mortgage obligations and mortgage backed securities, under the level yield method a new book yield is calculated each month based on the cash flows used to estimate the timing of principal and interest payments as of the redemption date. The Espiel Prepayment Model, which is based on dynamic vectored speeds, is the default cash flow approach for calculating the book yield, but cash flows based on the 1-month CPR historical speed and 3-month CPR historical speeds are also available.

Gains and losses on sales are recorded on the settlement date and determined using the specific identification method.

An investment security is impaired when its carrying value is greater than its fair value. Investment securities are evaluated for other-than-temporary impairment ("OTTI") on at least a quarterly basis and more frequently when economic or market conditions warrant such an evaluation. For securities in an unrealized loss position, management considers the magnitude and duration of the decline and the intent and ability of the Bank to retain its investment in the securities for a period of time sufficient to allow for an anticipated recovery in fair value, in addition to the reasons underlying the decline, to determine whether the loss in value is other than temporary. The term "other than temporary" is not intended to indicate that the decline is permanent, but indicates that the prospects for a near-term recovery of value is not necessarily favorable, or that there is a lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: 1) OTTI related to credit loss, which must be recognized in the income statement and 2) other-than-temporary impairment (OTTI) related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis. For equity securities, the entire amount of impairment is recognized through earnings.

LOANS HELD FOR SALE: Loans originated and intended for sale in the secondary market are carried at the lower of aggregate cost or fair value. Net unrealized losses, if any, are recorded as a valuation allowance and charged to earnings.

Loans held for sale are generally sold with servicing rights retained. The carrying value of loans sold is reduced by the amount allocated to the servicing right. If the loans are sold with servicing retained, the fair value of the servicing asset or liability is recorded on the balance sheet. Gains and losses on the sold portion of the loan is recognized at the time of sale based on the difference between the sale proceeds and the carrying value of the related loans sold. The servicing asset is amortized over an estimated life using a method approximating the level yield method; in the event future prepayments exceed management's estimates and future expected cash flows are inadequate to cover the unamortized servicing asset, additional amortization would be recognized. The portion of excess servicing fees in excess of the contractual servicing fees is reflected as interest-only (I/O) strips receivable, which are classified as interest-only strips receivable available for sale and are carried at fair value in other assets on the balance sheet.

LOANS: Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the amount of unpaid principal balances outstanding, net of deferred loan fees and costs, and an allowance for loan losses. Interest income is accrued on the unpaid principal balance daily and credited to income as it is earned. When a loan pays off or is sold, any unamortized balance of any related premiums, discounts, loan origination fees, and direct loan origination costs is recognized in income. Loan origination fees, net of certain direct origination costs, are deferred and amortized to interest income over the expected life of the loan using a method that approximates the level yield method without anticipating prepayments.

Accrual of interest is generally discontinued on loans which are more than 90 days delinquent or when management believes, after considering economic and business conditions and collection efforts, that the borrower's financial condition is such that collection of interest is doubtful unless the loan is well-secured and in the process of collection. Past due status is based on the contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged off at an earlier date if collection of principal or interest is considered doubtful. A loan is moved to nonaccrual status in accordance with the Bank's policy, typically after 90 days of non-payment.

When a loan is placed on nonaccrual status, all interest previously accrued but not collected is reversed from current period income. Interest received on such loans is then recognized only to the extent that cash is received and where the future collection of principal is probable, until qualifying for return to accrual. Generally, loans will be restored to an accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

CONCENTRATION OF CREDIT RISK: Most of the Bank's business activity is with customers located within Santa Cruz County. Therefore, the Bank's exposure to credit risk is significantly affected by changes in the economy in the Santa Cruz County area.

ALLOWANCE FOR LOAN LOSSES: The allowance for loan losses is an estimate of probable credit losses in the Bank's loan portfolio that have been incurred as of the balance sheet date. The allowance is established through a provision for loan losses which is charged to expense. Additions to the allowance are expected to maintain the adequacy of the total allowance after credit losses and loan growth. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Cash received on previously charged off amounts is recorded as a recovery to the allowance. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged off.

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement. Generally, the Bank identifies loans to be reported as impaired when such loans are in nonaccrual status or classified in part or in whole as either doubtful or loss. Loans for which the terms have been modified resulting in a concession, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired.

Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

Typically, loans below $100,000 from all class types are excluded from individual impairment analysis. When a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of expected future cash flows discounted at the loan's effective interest rate, except that as a practical expedient, it may measure impairment based on a loan's observable market price, or the fair value of the collateral if the loan is collateral dependent. A loan is collateral dependent if the repayment of the loan is expected to be provided solely by the underlying collateral.

Large groups of smaller balance homogeneous loans, such as consumer and residential real estate loans are collectively evaluated for impairment, and accordingly, they are not separately identified for impairment disclosures.

A restructuring of a debt constitutes a troubled debt restructuring (TDR) if the Bank, for economic or legal reasons related to the debtor's financial difficulties, grants a concession to the debtor that it would not otherwise consider. Restructured workout loans typically present an elevated level of credit risk as the borrowers are not able to perform according to the original contractual terms. Loans that are reported as TDRs are considered impaired and measured for impairment as described above.

The determination of the general reserve for loans that are not impaired is based on estimates made by management, to include, but not limited to, consideration of historical losses by portfolio segment, internal asset classifications, and qualitative factors to include economic trends in the Bank's service areas, industry experience and trends, geographic concentrations, estimated collateral values, the Bank's underwriting policies, the character of the loan portfolio, and probable losses inherent in the portfolio taken as a whole. The historical loss experience is determined by portfolio segment and is based on considerations of both the Bank's actual historical loss history and losses of the peer group in which the Bank operates over the most recent 5 years.

The Bank maintains a separate allowance for each portfolio segment (loan type). These portfolio segments include commercial real estate, land and construction, commercial and industrial, agricultural land, real estate and production, and consumer loans (principally home equity loans). Portfolio classes are not distinguished from segments for reporting purposes. The allowance for loan losses attributable to each portfolio segment, which includes both impaired loans and loans that are not impaired, is combined to determine the Bank's overall allowance, hence, is included on the balance sheet.

The general reserve component of the allowance for loan losses also consists of reserve factors that are based on management's assessment of the following for each portfolio segment: (1) inherent credit risk, (2) historical losses, and (3) other qualitative factors. These reserve factors are inherently subjective and are driven by the repayment risk associated with each portfolio segment described below.

Commercial real estate – Commercial real estate mortgage loans generally possess a higher inherent risk of loss than other real estate portfolio segments, except land and construction loans. Adverse economic developments or an overbuilt market impact commercial real estate projects and may result in troubled loans. Trends in vacancy rates of commercial properties impact the credit quality of these loans. High vacancy rates reduce operating revenues and the ability for properties to produce sufficient cash flow to service debt obligations.

Land and construction – Land and construction loans generally possess a higher inherent risk of loss than other real estate portfolio segments. A major risk arises from the necessity to complete projects within specified cost and time lines. Trends in the construction industry significantly impact the credit quality of these loans, as demand drives construction activity. In addition, trends in real estate values significantly impact the credit quality of these loans, as property values determine the economic viability of construction projects.

Commercial and industrial – Commercial and industrial loans generally possess a lower inherent risk of loss than real estate portfolio segments because these loans are generally underwritten to existing cash flows of operating businesses. Debt coverage is provided by business cash flows and economic trends influenced by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans.

Agricultural land, real estate and production – Agricultural real estate mortgage loans generally possess a lower inherent risk of loss than other real estate portfolio segments, including land and construction loans. Adverse economic developments may result in troubled loans. Loans secured by crop production and livestock are especially vulnerable to two risk factors that are largely outside the control of Bank and borrowers: commodity prices and weather conditions.

Consumer – Comprised of single family residential real estate, home equity lines of credit, personal lines and installment loans. The degree of risk in residential real estate lending depends primarily on the loan amount in relation to collateral value, the interest rate and the borrower's ability to repay in an orderly fashion. These loans generally possess a lower inherent risk of loss than other real estate portfolio segments. An installment loan portfolio is usually comprised of a large number of small loans scheduled to be amortized over a specific period. Most installment loans are made directly for consumer purchases, but business loans granted for the purchase of heavy equipment or industrial vehicles may also be included. Economic trends determined by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans. Weak economic trends indicate that the borrowers' capacity to repay their obligations may be deteriorating.

Although management believes the allowance to be adequate, ultimate losses may vary from its estimates. At least quarterly, the Board of Directors reviews the adequacy of the allowance, including consideration of the relative risks in the portfolio, current economic conditions and other factors. If the Board of Directors and management determine that changes are warranted based on those reviews, the allowance is adjusted. In addition, the Bank's primary regulators, FDIC and California Department of Business Oversight, as an integral part of their examination process, review the adequacy of the allowance. These regulatory agencies may require additions to the allowance based on their judgment about information available at the time of their examinations.

SERVICING RIGHTS: When mortgage loans are sold with servicing retained, servicing rights are initially recorded at fair value with the income statement effect recorded in gains on sales of loans. Fair value is based on market prices for comparable mortgage servicing contracts, when available or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. All classes of servicing assets are subsequently measured using the amortization method which requires servicing rights to be amortized into non interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying loans.

Servicing rights are evaluated for impairment based upon the fair value of the rights as compared to carrying amount. Impairment is determined by stratifying rights into groupings based on predominant risk characteristics, such as interest rate, loan type and investor type. Impairment is recognized through a valuation allowance for an individual grouping, to the extent that fair value is less than the carrying amount. If the Bank later determines that all or a portion of the impairment no longer exists for a particular grouping, a reduction of the allowance may be recorded as an increase to income. Changes in valuation allowances are reported with loan servicing fees income on the income statement. The fair values of servicing rights are subject to significant fluctuations as a result of changes in estimated and actual prepayment speeds and default rates and losses.

Servicing fee income, which is reported on the income statement as loan servicing fees, is recorded for fees earned on servicing loans. The fees are based on a fixed amount per loan and recorded as income when earned. The amortization of servicing rights is netted against loan servicing fee income. Servicing fees totaled $396,135 and $304,965 for the years ended December 31, 2013 and 2012, respectively. Late fees and ancillary fees related to loan servicing are not material.

FORECLOSED ASSETS: Assets acquired through or instead of foreclosure are initially recorded at fair value of the property, less estimated selling expenses, establishing a new cost basis. Any write-down to fair value at the time of transfer to foreclosed real estate is charged to the allowance for loan losses. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell.

If fair value declines subsequent to foreclosure, a valuation allowance is recorded through expense. Operating costs after acquisition are expensed. Operating expenses incurred in conjunction with the maintenance of real estate acquired through foreclosure are charged to operations as incurred.

PREMISES AND EQUIPMENT: Premises and equipment are stated at cost less accumulated depreciation and amortization. Leasehold improvements are amortized over the shorter of the estimated useful life or the initial term of the respective leases. Certain operating leases contain incentives in the form of tenant improvement allowances or credits. Lease incentives are capitalized at the inception of the lease and amortized on a straight-line basis over the original lease term with useful lives ranging from 3 to 10 years. Furniture, fixtures and equipment are depreciated using the straight line method with useful lives ranging from 5 to 7 years. All other maintenance and repair expenditures are expensed as incurred.

FEDERAL HOME LOAN BANK STOCK: The Bank, as a member of the Federal Home Loan Bank ("FHLB") system, is required to maintain an investment in the capital stock of the FHLB of San Francisco based on the level of borrowings and other factors, and may invest in additional amounts. FHLB stock is carried at cost, classified as restricted security, and periodically evaluated for impairment based on ultimate recovery of par value. The FHLB stock is redeemable at its par value of $100 per share at the discretion of the FHLB of San Francisco. The FHLB can suspend dividends and redemptions upon notification to its members. Both cash and stock dividends, if any, are reported as income.

PACIFIC COAST BANKERS BANK STOCK: PCBB stock is carried at cost, classified as restricted security, and periodically evaluated for impairment based on ultimate recovery of par value. Both cash and stock dividends, if any, are reported as income.

BANK OWNED LIFE INSURANCE: The Bank has purchased life insurance policies on certain key executives. Bank owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

LOAN COMMITMENTS AND RELATED FINANCIAL INSTRUMENTS: Financial instruments include off balance sheet credit instruments, such as commitments to make loans and commercial letters of credit, issued to meet customer financing needs. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded.

STOCK-BASED COMPENSATION: The Bank has a stock-based compensation plan for employees and directors, the 2003 Stock Option Plan (the "Option Plan"), which has been approved by its shareholders. The Option Plan permits the grant of stock options for up to 500,202 shares of the Bank's common stock. The amount, frequency, and terms of stock-based awards may vary based on competitive practices, the Bank's operating results, and government regulations.

The Bank has a Stock Award Plan, the 2011 Restricted Stock Award Plan (the "Award Plan"). The Award Plan permits the grant of stock awards for the lesser of (i) 218,390 shares or (ii) the difference between 500,202 and the sum of the number of shares underlying stock options outstanding or granted after April 11, 2011 and the number of shares of Restricted Stock Awards granted. Awards vest at a rate of no more than 25% per year and fully vest in four years from the date of grant. All stock certificates issued pursuant to a Restricted Stock Award shall remain in the possession of Santa Cruz County Bank until the terms and provisions of the Restricted Stock Award have been fully satisfied. Shares are redeemable upon the fourth anniversary from the date of the grant or earlier as a result of a qualifying terminating event.

Compensation cost is recognized for stock options and restricted stock awards issued to employees and directors, based on the fair value of these awards at the date of grant. The Bank estimates the fair value of each stock option award as of the date of grant using a Black-Scholes model, while the market price of the Bank's common stock at the date of grant is used for restricted stock awards.

Compensation cost is recognized over the required service period, generally defined as the vesting period. For awards with graded vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award.

INCOME TAXES: Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred income taxes are computed using the asset and liability method, which recognizes a liability or asset representing the tax effects, based on current tax law, of future deductible or taxable amounts attributable to events that have been recognized in the financial statements. A valuation allowance is established to reduce the deferred tax asset to the level at which it is "more likely than not" that the tax asset or benefits will be realized. Deferred tax assets and liabilities are calculated by applying current enacted tax rates against future deductible or taxable amounts. Realization of tax benefits of deductible temporary differences and operating loss carry forwards depends on having sufficient taxable income of an appropriate character within the carry forward periods.

The Bank uses a comprehensive model for recognizing, measuring, presenting and disclosing in the financial statements tax positions taken or expected to be taken on a tax return. A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded.

The Bank recognizes interest and/or penalties related to income tax matters in income tax expense.

RETIREMENT PLANS: Pension expense is the net of service and interest cost, return on plan assets and amortization of gains and losses not immediately recognized. Employee 401(k) plan expense is the amount of matching contributions. Deferred compensation and supplemental retirement plan expense allocates the benefits over years of service.

EARNINGS PER COMMON SHARE: Basic earnings per common share are calculated by dividing net earnings for the period by the weighted-average common shares outstanding during the period. Diluted earnings per share takes into account the potential dilutive impact of such instruments and uses the average share price for the period in determining the number of incremental shares to add to the weighted-average number of shares outstanding. There is no adjustment to the number of outstanding shares for potential dilutive instruments, such as stock options, when a loss occurs because the conversion of potential common stock is anti-dilutive or when stock options are not in-the-money.

COMPREHENSIVE (LOSS) INCOME: Comprehensive (loss) income consists of net income and other comprehensive (loss) income. Other comprehensive earnings include the adjustment to fully recognize the liability associated with the supplemental executive retirement plan and unrealized gains and losses on securities available for sale, which are also recognized as separate components of equity.

LOSS CONTINGENCIES: Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. In 2013, an Action was filed against the Bank in the District Court of California, San Jose Division, which alleges claims for relief related to several counts of conspiracy and negligence. The Action was brought against the Bank by a group of individual investors that allege fraud was perpetrated by an investment fund, which conducted business with and was serviced by representatives of the Bank. The Action is not alleged to be a class action. The Bank denies liability and is vigorously defending the Action. The case has been deferred until the end of the related criminal trial, of which the Bank is not a party nor a defendant in that criminal case. The outcome of these matters is currently undeterminable, and potential range of loss to the Bank, if any, is unknown.

DIVIDEND RESTRICTION: Banking regulations require maintaining certain capital levels and may limit the dividends paid by the Bank to shareholders.

FAIR VALUE OF FINANCIAL INSTRUMENTS: The Bank's estimated fair value amounts have been determined by the Bank using available market information and other assumptions, as more fully disclosed in a separate note. Considerable judgment is required to develop the estimates of fair value. Accordingly, the estimates are not necessarily indicative of the amounts the Bank could have realized 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.

Although management is not aware of any factors that would significantly affect the estimated fair value amounts, such amounts have not been comprehensively revalued for purposes of these financial statements since the balance sheet date and, therefore, current estimates of fair value may differ significantly from the amounts presented in the accompanying Notes.

RECLASSIFICATIONS: Certain reclassifications have been made to prior period financial statements to conform to the current year presentation. These reclassifications had no impact on the Bank's previously reported financial statements.

Adoption of New Accounting Standards

In July 2013, the FASB amended existing guidance related to the presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss or a tax credit carryforward exists. These amendments provide that an unrecognized tax benefit, or a portion thereof, be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except to the extent that a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date to settle any additional income taxes that would result from disallowance of a tax position, or the tax law does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, then the unrecognized tax benefit should be presented as a liability. The effect of adopting this standard did not have a material effect on the Bank's operating results or financial condition.

In February 2013, the FASB amended existing guidance related to reporting amounts reclassified out of accumulated other comprehensive (loss) income. These amendments do not change the current requirements for reporting net income or other comprehensive income in financial statements. These amendments require an entity to provide information about the amounts reclassified out of accumulated other comprehensive (loss) income by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive (loss) income by the respective line items of net income but only if the amount reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required under U.S. GAAP that provide additional details about those amounts. The effect of adopting this standard did not have a material effect on the Bank's operating results or financial condition.

NOTE 2. INVESTMENT SECURITIES

The following tables summarize the amortized cost and fair value of securities available for sale and held to maturity at December 31, 2013, and 2012 and the corresponding amounts of gross unrealized gains and losses recognized in accumulated other comprehensive income (loss) and gross unrecognized gains and losses:

December 31, 2013	Amortized Cost	Gross Unrecognized Gains	Gross Unrecognized Losses	Estimated Fair Value
Held to maturity:				
U.S. government sponsored agencies	$ 8,157,484	$ 41,082	$ (19,581)	$ 8,178,985
Mortgage backed securities: residential	11,130,633	43,879	(7,252)	11,167,260
Collateralized mortgage obligations	19,726,193	23,247	(71,169)	19,678,271
State and political subdivision	13,702,110	126,025	(15,175)	13,812,960
Corporate	549,585	560	(4)	550,141
Total held to maturity	$ 53,266,005	$ 234,793	$ (113,181)	$ 53,387,617

December 31, 2012	Amortized Cost	Gross Unrecognized Gains	Gross Unrecognized Losses	Estimated Fair Value
Available for sale:				
U.S. government sponsored agencies	$ 1,094,432	$ 48,927	$ -	$ 1,143,359
Mortgage backed securities: residential	5,110,771	149,231	(28,238)	5,231,764
Collateralized mortgage obligations	18,569,937	171,571	(49,847)	18,691,661
State and political subdivision	13,234,099	831,304	-	14,065,403
Total available for sale	$ 38,009,239	$ 1,201,033	$ (78,085)	$ 39,132,187

	Amortized Cost	Gross Unrecognized Gains	Gross Unrecognized Losses	Estimated Fair Value
Held to maturity:				
Mortgage backed securities: residential	176,866	10,108	-	186,974
Total held to maturity	$ 176,866	$ 10,108	$ -	$ 186,974

During the third quarter of 2013, the Bank transferred $43,169,507 of available for sale securities to the held to maturity category.

The proceeds from sales and calls of investment securities and associated gains and losses are listed below:

	2013	2012
Proceeds	607,187	850,000
Gains	31,782	2,039
Losses	(1)	-

The tax provision related to these net realized gains and losses were $13,079 and $839, respectively.

The amortized cost and estimated fair value of debt securities are shown by contractual maturity. Expected maturities may differ from contractual maturities if borrowers have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity date are shown separately.

	2013	
	Amortized Cost	Estimated Fair Value
Held to maturity:		
Within one year	$ 1,351,243	$ 1,352,776
One to five years	9,684,551	9,712,028
Five to ten years	4,215,614	4,245,495
Beyond ten years	7,157,772	7,231,787
Mortgage-backed securities	30,856,825	30,845,531
Total	$ 53,266,005	$ 53,387,617

Investment securities pledged to secure public deposits at year end December 31, 2013 and 2012 had a carrying amount of $17,700,000 and $17,110,000, respectively.

At year end 2013 and 2012, there were no holdings of securities of any one issuer, other than the U.S. Government and its agencies, in an amount greater than 10% of shareholders' equity.

The following table summarizes investment securities with unrealized losses at December 31, 2013 and 2012 aggregated by major security type and length of time in a continuous unrealized loss position:

December 31, 2013:	Less than 12 months		12 months or more		Total	
Held to maturity:	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. government sponsored agencies	$ 7,851,625	$ (26,834)	$ -	$ -	$ 7,851,625	$ (26,834)
Collateralized mortgage obligations	12,455,357	(71,169)	-	-	12,455,357	(71,169)
State and political subdivision	1,489,828	(15,174)	-	-	1,489,828	(15,174)
Corporate	12,163	(4)	-	-	12,163	(4)
Total available for sale:	$ 21,808,973	$ (113,181)	$ -	$ -	$ 21,808,973	$ (113,181)

December 31, 2012:	Less than 12 months		12 months or more		Total	
Available for sale:	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. government sponsored agencies	$ 2,444,957	$ (28,238)	$ -	$ -	$ 2,444,957	$ (28,238)
Collateralized mortgage obligations	3,458,440	(16,855)	1,577,009	(32,992)	5,035,449	$ (49,847)
State and political subdivision	-	-	-	-	-	-
Corporate	-	-	-	-	-	-
Total available for sale:	$ 5,903,397	$ (45,093)	$ 1,577,009	$ (32,992)	$ 7,480,406	$ (78,085)

As of December 31, 2013, the Bank's security portfolio consisted of 199 investment securities, 27 of which were in an unrealized loss position. The majority of unrealized losses are related to the Bank's collateralized mortgage obligations as discussed below.

Collateralized Mortgage Obligations:

At December 31, 2013, 100% of the collateralized mortgage obligations held by the Bank were issued by U.S. Government or government-sponsored entities and agencies, primarily Fannie Mae and Freddie Mac, institutions which the government has affirmed its commitment to support. Because the decline in fair value is attributable to changes in interest rates and illiquidity, and not credit quality, and because the Bank does not have the intent to sell these mortgage backed securities and it is likely that it will not be required to sell the securities before their anticipated recovery, the Bank does not consider these securities to be other-than-temporarily impaired at December 31, 2013. The Bank's mortgage backed securities portfolio does not include non-agency collateralized mortgage obligations.

NOTE 3. LOANS RECEIVABLE

The outstanding loan portfolio balances at December 31, 2013 and 2012 are as follows:

	December 31, 2013	December 31, 2012
Commercial and industrial	$ 67,853,035	$ 68,938,274
Commercial real estate	116,132,352	89,810,098
Land and construction	7,451,251	4,210,255
Agricultural land, real estate and production	11,249,567	10,134,823
Consumer	31,726,162	32,749,369
Gross loans receivable	234,412,367	205,842,819
Net deferred loan fees	561,302	199,422
Allowance for loan losses	(5,705,862)	(5,048,577)
Loans receivable, net	$ 229,267,807	$ 200,993,664

	December 31, 2013	December 31, 2012
Commercial and industrial	$ 3,198,900	$ 3,800,867
Commercial real estate	18,369,259	13,275,137
Land and construction	-	2,322,592
Agricultural land, real estate and production	2,147,920	437,068
Loans held for sale	$ 23,716,079	$ 19,835,664

The following table shows the allocation of the allowance for loan losses by portfolio segment for the years ended December 31, 2013 and December 31, 2012:

December 31, 2013:	Commercial and Industrial	Commercial Real Estate	Land and Construction	Agricultural Land, Real Estate and Production	Consumer	Unallocated	Total
Allowance for loan losses:							
Beginning balance	$ 2,105,429	$ 1,699,617	$ 289,215	$ 57,486	$ 583,790	$ 313,040	$ 5,048,577
Provision for loan losses	(62,238)	654,467	141,967	(12,183)	(71,118)	(163,395)	487,500
Loans charged-off	(39,411)	(42,541)				-	(81,952)
Recoveries	13,132	8,750	229,855	-		-	251,737
Total ending allowance balance	$ 2,016,912	$ 2,320,293	$ 661,037	$ 45,303	$ 512,672	$ 149,645	$ 5,705,862

December 31, 2012:	Commercial and Industrial	Commercial Real Estate	Land and Construction	Agricultural Land, Real Estate and Production	Consumer	Unallocated	Total
Allowance for loan losses:							
Beginning balance	$ 1,597,966	$ 1,310,205	$ 955,229	$ 56,160	$ 385,730	$ -	$ 4,305,290
Provision for loan losses	519,875	512,358	(554,851)	1,326	202,252	313,040	994,000
Loans charged-off	(73,552)	(122,946)	(111,163)		(4,692)	-	(312,353)
Recoveries	61,140	-	-	-	500	-	61,640
Total ending allowance balance	$ 2,105,429	$ 1,699,617	$ 289,215	$ 57,486	$ 583,790	$ 313,040	$ 5,048,577

The following table shows the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of December 31, 2013 and 2012:

December 31, 2013:	Commercial and Industrial	Commercial Real Estate	Land and Construction	Agricultural Land, Real Estate and Production	Consumer	Unallocated	Total
Allowance for loan losses							
Ending allowance balance attributable to loans:							
Individually evaluated for impairment	$ 59,742	$ 63,605	$ -	$ -	$ -	$ -	$ 123,347
Collectively evaluated for impairment	1,957,170	2,256,688	661,037	45,303	512,672	149,645	5,582,515
Total ending allowance balance	$ 2,016,912	$ 2,320,293	$ 661,037	$ 45,303	$ 512,672	$ 149,645	$ 5,705,862
Loans							
Loans individually evaluated for impairment	$ 265,819	$ 356,377	$ -	$ -	$ -	$ -	$ 622,196
Loans collectively evaluated for impairment	67,587,216	115,775,975	7,451,251	11,249,567	31,726,162	-	233,790,171
Total ending loans balance	$ 67,853,035	$ 116,132,352	$ 7,451,251	$ 11,249,567	$ 31,726,162	$ -	$ 234,412,367

December 31, 2012:	Commercial and Industrial	Commercial Real Estate	Land and Construction	Agricultural Land, Real Estate and Production	Consumer	Unallocated	Total
Allowance for loan losses							
Ending allowance balance attributable to loans:							
Individually evaluated for impairment	$ 65,179	$ 143,030	$ 63,750	$ -	$ -	$ -	$ 271,959
Collectively evaluated for impairment	2,040,250	1,556,587	225,465	57,486	583,790	313,040	4,776,618
Total ending allowance balance	$ 2,105,429	$ 1,699,617	$ 289,215	$ 57,486	$ 583,790	$ 313,040	$ 5,048,577
Loans							
Loans individually evaluated for impairment	$ 289,163	$ 1,376,710	$ 656,269	$ -	$ -	$ -	$ 2,322,142
Loans collectively evaluated for impairment	68,649,111	88,433,388	3,553,986	10,134,823	32,749,369	-	203,520,677
Total ending loans balance	$ 68,938,274	$ 89,810,098	$ 4,210,255	$ 10,134,823	$ 32,749,369	$ -	$ 205,842,819

The following table shows information related to impaired loans, by class of loans, as of and for the year ended December 31, 2013 and 2012:

Impaired Loans
For the Year ended December 31, 2013

	Unpaid Principal Balance	Recorded Investment	Allowance for loan losses allocated	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Recognized
With no related allowance recorded:						
Commercial real estate	$ 102,715	$ 42,509	$ -	$ 43,983	$ -	$ 8,128
Total	102,715	42,509	-	43,983	-	8,128
With an allowance recorded:						
Commercial and industrial	265,819	265,819	59,742	212,436	20,271	-
Commercial real estate	313,868	313,868	63,605	264,723	28,038	-
Total	579,687	579,687	123,347	477,159	48,309	-
Total:						
Commercial and industrial	265,819	265,819	59,742	212,436	20,271	-
Commercial real estate	416,583	356,377	63,605	308,706	28,038	8,128
Total	$ 682,402	$ 622,196	$ 123,347	$ 521,142	$ 48,309	$ 8,128

Impaired Loans
For the Year ended December 31, 2012

	Unpaid Principal Balance	Recorded Investment	Allowance for loan losses allocated	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Recognized
With no related allowance recorded:						
Commercial real estate	$ 926,916	$ 866,710	$ -	$ 903,335	$ 49,403	$ 7,956
Total	926,916	866,710	-	903,335	49,403	7,956
With an allowance recorded:						
Commercial and industrial	289,163	289,163	65,179	119,490	17,122	-
Commercial real estate	510,000	510,000	143,030	370,078	30,644	-
Land and construction	656,269	656,269	63,750	601,692	-	-
Total	1,455,432	1,455,432	271,959	1,091,260	47,766	-
Total:						
Commercial and industrial	289,163	289,163	65,179	119,490	17,122	-
Commercial real estate	1,436,916	1,376,710	143,030	1,273,413	80,047	7,956
Land and construction	656,269	656,269	63,750	601,692	-	-
Total	$ 2,382,348	$ 2,322,142	$ 271,959	$ 1,994,595	$ 97,169	$ 7,956

The recorded investment in loans excludes accrued interest receivable and loan origination fees, net due to immateriality. For purposes of this disclosure, the unpaid principal balance is not reduced for partial charge-offs.

Nonaccrual loans and loans past due 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified as impaired loans.

The following table shows an aging analysis of the recorded investment in past due loans as of December 31, 2013 and 2012 by class of loans:

December 31, 2013	30-89 Days Past Due	90 Days and Still Accruing	Nonaccrual	Total Past Due	Current	Total
Commercial and industrial	$ 30,364	$ 261,228	$ -	$ 291,592	$ 67,561,443	$ 67,853,035
Commercial real estate	-	-	42,509	42,509	116,089,843	116,132,352
Land and construction	-	-	-	-	7,451,251	7,451,251
Agricultural land, real estate and production	-	-	-	-	11,249,567	11,249,567
Consumer	139,481	-	-	139,481	31,586,681	31,726,162
Total	$ 169,845	$ 261,228	$ 42,509	$ 473,582	$ 233,938,785	$ 234,412,367

December 31, 2012	30-89 Days Past Due	90 Days and Still Accruing	Nonaccrual	Total Past Due	Current	Total
Commercial and industrial	$ 297,551	$ -	$ -	$ 297,551	$ 68,640,723	$ 68,938,274
Commercial real estate	-	-	184,780	184,780	89,625,318	89,810,098
Land and construction	-	-	-	-	4,210,255	4,210,255
Agricultural land, real estate and production	-	-	-	-	10,134,823	10,134,823
Consumer	2,010	-	-	2,010	32,747,359	32,749,369
Total	$ 299,561	$ -	$ 184,780	$ 484,341	$ 205,358,478	$ 205,842,819

Troubled Debt Restructurings:

As of December 31, 2013 and 2012, the Bank has a recorded investment in troubled debt restructurings of $261,228 and $1,039,216, respectively. The Bank has allocated $59,689 and $65,164 in specific reserves to customers whose loan terms have been modified in troubled debt restructurings as of December 31, 2013 and 2012. The Bank has not committed to lend additional amounts as of December 31, 2013 to customers with outstanding loans that are classified as troubled debt restructurings.

During the years ending December 31, 2013 and 2012, the terms of certain loans were modified as troubled debt restructurings. The modification of the terms of such loans included one or a combination of the following: a reduction of the stated interest rate of the loan; an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk; or a permanent reduction of the recorded investment in the loan.

Modifications involving a reduction of the stated interest rate of the loan were for periods ranging from 6 months to 1 year. Modifications involving an extension of the maturity date were for periods ranging from 6 months to 1 year.

The following table presents loans by class modified as troubled debt restructurings that occurred during the years ending December 31, 2013 and 2012:

		Modifications	
December 31, 2013	Number of Loans	Pre-modification Outstanding Recorded Investments	Post-modification Outstanding Recorded Investments
Troubled Debt Restructuring:			
Commercial	1	$ 261,228	$ 261,228

December 31, 2012	Number of Loans	Pre-modification Outstanding Recorded Investments	Post-modification Outstanding Recorded Investments
Troubled Debt Restructuring:			
Commercial	4	$ 1,039,216	$ 1,039,216

There were no troubled debt restructurings that subsequently defaulted in 2013 or 2012, respectively. For the years ending December 31, 2013 and 2012, the troubled debt restructurings did not increase the allowance for loan losses and resulted in no charge-offs.

Credit Quality Indicators:

The Bank assigns a risk rating to all loans and periodically performs detailed reviews of all such loans over a certain threshold to identify credit risks and to assess the overall collectability of the portfolio. These risk ratings are also subject to examination by independent specialists engaged by the Bank and the Bank's regulators. During these internal reviews, management monitors and analyzes the financial condition of borrowers and guarantors, trends in the industries in which borrowers operate and the fair values of collateral securing these loans. These credit quality indicators are used to assign a risk rating to each individual loan. The risk ratings can be grouped into five major categories, defined as follows:

Pass A pass loan is a credit with no existing or known potential weaknesses deserving of management's close attention.

Special Mention A special mention loan has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or in the Bank's credit position at some future date. Special Mention loans are not adversely classified and do not expose the Bank to sufficient risk to warrant adverse classification.

Substandard A substandard loan is not adequately protected by the current sound worth and paying capacity of the borrower or the value of the collateral pledged, if any. Loans classified as substandard have a well defined weakness or weaknesses that jeopardize the liquidation of the debt. Well defined weaknesses include a project's lack of marketability, inadequate cash flow or collateral support, failure to complete construction on time or the project's failure to fulfill economic expectations. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Doubtful Loans classified doubtful have all the weaknesses inherent in those classified as substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions and values, highly questionable, and improbable.

Loss Loans classified as loss are considered uncollectible and charged off immediately.

The following table shows the loan portfolio by class allocated by management's internal risk ratings at December 31, 2013 and 2012:

December 31, 2013	Commercial and Industrial	Commercial Real Estate	Land and Construction	Agricultural Land, Real Estate and Production	Consumer	Total
Pass	$ 67,416,816	$ 113,051,326	$ 7,451,251	$ 11,249,567	$ 30,563,177	$ 229,732,137
Special Mention	436,219	2,819,798	-	-	1,155,748	4,411,765
Substandard		261,228	-	-	7,237	268,465
Doubtful		-	-	-	-	-
Total	$ 67,853,035	$ 116,132,352	$ 7,451,251	$ 11,249,567	$ 31,726,162	$ 234,412,367

December 31, 2012	Commercial and Industrial	Commercial Real Estate	Land and Construction	Agricultural Land, Real Estate and Production	Consumer	Total
Pass	$ 68,657,965	$ 85,831,089	$ 3,553,986	$ 10,134,823	$ 31,465,761	$ 199,643,624
Special Mention	205,329	2,918,609	-	-	1,274,601	4,398,539
Substandard	74,980	1,060,400	656,269	-	9,007	1,800,656
Doubtful	-	-	-	-	-	-
Total	$ 68,938,274	$ 89,810,098	$ 4,210,255	$ 10,134,823	$ 32,749,369	$ 205,842,819

NOTE 4. REAL ESTATE OWNED

Real estate owned activity was as follows:

	2013	2012
Beginning balance	$ 3,166,000	$ 2,931,889
Loans transferred to real estate owned	216,327	3,455,499
Capitalized expenditures	162,699	-
Recovery / (write-downs)	111,163	(95,337)
Sale proceeds of real estate owned, net of gain	(3,297,605)	(3,126,051)
End of year	$ 358,584	$ 3,166,000

(Income)/Expenses related to foreclosed assets are reported in Other expenses on the income statement and include:

	2013	2012
Beginning of year	$ 3,166,000	$ 2,931,889
Additions/(recoveries) charged/(credited) to expense	490,190	3,360,162
Reductions from sales of real estate owned	(3,297,606)	(3,126,051)
End of year	$ 358,584	$ 3,166,000

NOTE 5. FAIR VALUE

Fair Value Hierarchy:

The Bank groups its assets and liabilities measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. Valuations within these levels are based upon:

Level 1 – Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2 – Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

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

The Bank used the following methods and significant assumptions to estimate fair value:

CASH AND CASH EQUIVALENTS: The carrying amount of cash and cash equivalents is a reasonable estimate of fair value and are classified as Level 1.

INTEREST BEARING DEPOSITS IN OTHER FINANCIAL INSTITUTIONS: The fair values were calculated using discounted cash flow models based on market rates resulting in a Level 2 classification.

INVESTMENT SECURITIES: The fair values of securities classified as available for sale and held to maturity are based on quoted market prices, if available (Level 1) at the reporting date. For securities where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3).

LOANS HELD FOR SALE: Loans held for sale are carried at the lower of cost or fair value, which is evaluated on a pool-level basis. The fair value of loans held for sale is determined using quoted prices for similar assets, adjusted for specific attributes of that loan or other observable market data, such as outstanding commitments from third party investors (Level 2).

LOANS: The fair value of fixed rate loans is determined as the present value of expected future cash flows discounted at the interest rate currently offered by the Bank, which approximates rates currently offered by local lending institutions for loans of similar terms to companies with comparable credit risk resulting in a Level 3 classification. Variable rate loans which re-price frequently with changes in approximate market rates were valued using the outstanding principal balance resulting in a Level 3 classification. The estimated fair value of loan commitments and contingent liabilities at December 31, 2013 and December 31, 2012 approximate their current book values.

IMPAIRED LOANS: The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.

REAL ESTATE OWNED: Non-recurring adjustments to certain commercial and residential real estate properties classified as real estate owned (REO) are measured at fair value, less costs to sell. Fair values are based on recent real estate appraisals. These appraisals may use a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.

BANKERS' BANK STOCK: Bankers' Bank Stock includes Federal Home Loan Bank Stock and Pacific Coast Bankers Bank Stock. The Federal Home Loan Bank investment is carried at cost and is redeemable at par with certain restrictions. It is not practical to determine fair value of bank stock due to restrictions placed on transferability.

ACCRUED INTEREST RECEIVABLE/PAYABLE: The carrying amounts of accrued interest approximate their fair value resulting in a Level 2 or Level 3 classification.

DEPOSITS: The fair values of demand deposits, savings deposits, and money market deposits without defined maturities were the amounts payable on demand resulting in a Level 1 classification. For variable rate deposits where the Bank has the contractual right to change rates, carrying value was assumed to approximate fair value resulting in a Level 1 classification.

CERTIFICATES OF DEPOSIT: For deposits with defined maturities, the fair values were calculated using discounted cash flow models based on market interest rates for different product types and maturity dates. The discount rates used were based on rates for comparable deposits resulting in a Level 2 classification.

Assets Recorded at Fair Value

The Bank's assets and liabilities measured at fair value on a recurring and non-recurring basis as of December 31, 2013 and 2012 are summarized below:

RECURRING BASIS

The Bank is required or permitted to record the following assets at fair value on a recurring basis.

	December 31, 2012			
	Fair Value	Level 1	Level 2	Level 3
Securities available for sale:				
U.S. government sponsored agencies	$ 1,143,359	$ -	$ 1,143,359	$ -
Mortgage backed securities: residential	5,231,764	-	5,231,764	-
Collateralized mortgage obligations	18,691,661	-	18,691,661	-
State and political subdivision	14,065,403	-	14,065,403	-
Corporate	-	-	-	-
Total assets measured at fair value	$ 39,132,187	$ -	$ 39,132,187	$ -

Fair values for available for sale investment securities are based on quoted market prices for similar securities. The Bank did not have securities available for sale at year end December 31, 2013. During the year ended December 31, 2013 and 2012, there were no transfers in or out of Levels 1 and 2.

There were no recurring Level 3 assets or liabilities measured at fair value during 2013 or 2012.

NON-RECURRING BASIS

The Bank may be required, from time to time, to measure certain assets at fair value on a non-recurring basis. These include assets that are measured at the lower of cost or market value that were recognized at fair value which was below cost at the reporting date:

	December 31, 2013				
	Fair Value	Level 1	Level 2	Level 3	Total (Losses)
Impaired loans:					
Commercial and industrial	$ 207,076	$ -	$ -	$ 207,076	$ (5,437)
Commercial real estate	250,263	-	-	250,263	(8,754)
Land and construction	-	-	-	-	-
Real estate owned:					
Commercial real estate	158,584	-	-	158,584	-
Land and construction	200,000	-	-	200,000	-
Total assets measured at fair value	$ 815,923	$ -	$ -	$ 815,923	$ (14,191)

Non-recurring Basis

	December 31, 2012				
	Fair Value	Level 1	Level 2	Level 3	Total Gains (Losses)
Impaired loans:					
Commercial and industrial	$ 223,984	$ -	$ -	$ 223,984	$ 9,390
Commercial real estate	366,970	-	-	366,970	(14,986)
Land and construction	592,519	-	-	592,519	(324,447)
Real estate owned:					
Commercial real estate	-	-	-	-	-
Land and construction	3,166,000	-	-	3,166,000	-
Total assets measured at fair value	$ 4,349,473	$ -	$ -	$ 4,349,473	$ (330,043)

The impaired loans and real estate owned fair values are determined using independent appraisers. The Bank considers these third-party appraisals as Level 3 classifications due to the significant unobservable inputs used to measure the fair values of these properties. These unobservable inputs include adjustments for differences between comparable sales and discount rates.

The following table presents the carrying amounts and estimated fair values of the Bank's financial instruments at December 31, 2013 and December 31, 2012. The fair value of financial instruments does not represent actual amounts that may be realized upon any sale or liquidation of the related assets or liabilities. In addition, these values do not give effect to discounts to fair value which may occur when financial instruments are sold in larger quantities. The fair values presented represent the Bank's best estimate of fair value using the methodologies discussed below.

The respective carrying values of certain on-balance-sheet financial instruments approximated their fair values. These financial instruments include accrued interest receivable and accrued interest payable. Carrying values were assumed to approximate fair values for these financial instruments as they are short term in nature and their recorded amounts approximate fair values or are receivable or payable on demand. The Bank does not use derivative financial instruments.

December 31, 2013

(Dollars in thousands)	Carrying Amount	Level 1	Level 2	Level 3	Total
Financial Assets:					
Cash and cash equivalents	$ 12,131	$ 12,131	$ -	$ -	$ 12,131
Interest bearing deposits in other Financial Institutions	66,716	-	67,426	-	67,426
Securities available-for-sale	-	-	-	-	-
Securities held-to-maturity	53,266	-	53,388	-	53,388
Loans held for sale	23,716	-	23,716	-	23,716
Loans, net	229,268	-	-	233,527	233,527
Bankers' Bank stock	1,354	N/A	N/A	N/A	N/A
Accrued interest receivable	1,313	18	410	885	1,313
Financial Liabilities:					
Noninterest-bearing demand deposits	$ 166,022	$ 166,022	$ -	$ -	$ 166,022
Interest-bearing demand deposits	43,827	43,663	-	-	43,663
Savings and money market deposits	89,055	89,002	-	-	89,002
Time certificates of deposit	61,336	-	61,366	-	61,366
Accrued interest payable	89	4	85	-	89

December 31, 2012

(Dollars in thousands)	Carrying Amount	Level 1	Level 2	Level 3	Total
Financial Assets:					
Cash and cash equivalents	$ 12,368	$ 12,368	$ -	$ -	$ 12,368
Interest bearing deposits in other Financial Institutions	67,677	-	68,569	-	68,569
Securities available-for-sale	39,132	-	39,132	-	39,132
Securities held-to-maturity	177	-	187	-	187
Loans held for sale	19,836	-	19,836	-	19,836
Loans, net	200,994	-	-	207,141	207,141
Bankers' Bank stock	1,247	N/A	N/A	N/A	N/A
Accrued interest receivable	1,191	79	253	859	1,191
Financial Liabilities:					
Noninterest-bearing demand deposits	$ 139,695	$ 139,695	$ -	$ -	$ 139,695
Interest-bearing demand deposits	38,997	38,987	-	-	38,987
Savings and money market deposits	78,582	78,551	-	-	78,551
Time certificates of deposit	64,316	-	64,340	-	64,340
Accrued interest payable	90	4	86	-	90

Management monitors the availability of observable market data to assess the appropriate classification of financial instruments within the fair value hierarchy. Changes in economic conditions or model-based valuation techniques may require the transfer of financial instruments from one fair value level to another. In such instances, the transfer is reported at the beginning of the reporting period.

Management evaluates the significance of transfers between levels based upon the nature of the financial instrument and size of the transfer relative to total assets, total liabilities or total earnings.

NOTE 6. LOAN SERVICING

Activity for loan servicing rights and the related valuation allowance follows:

	2013	2012
Loan servicing rights:		
Beginning of year	$ 509,364	$ 466,495
Additions	289,384	210,124
Disposals	(10,476)	-
Amortized to expense	(199,369)	(167,255)
End of year	$ 588,903	$ 509,364

The Bank reviews servicing rights for impairment periodically and there was no valuation allowance recorded in 2013 or 2012.

NOTE 7. PREMISES AND EQUIPMENT

The following presents the cost of premises and equipment including leasehold improvements and the related accumulated depreciation and amortization at December 31, 2013 and 2012:

	December 31, 2013	December 31, 2012
Leasehold improvements	$ 1,743,123	$ 1,743,123
Furniture, fixtures and equipment	1,660,404	1,637,578
Software and capitalized data & item processing	234,425	238,925
Computer equipment	654,856	655,063
Total premises and equipment	4,292,808	4,274,689
Less accumulated depreciation and amortization	(3,453,792)	(3,110,335)
Premises and equipment, net	$ 839,016	$ 1,164,354

Depreciation expense was $389,132 and $374,169 for 2013 and 2012.

OPERATING LEASES: The Bank leases various branch premises under long-term operating lease agreements. These leases expire on various dates through 2020 and have various renewal options of five years each. Some leases may include a free rent period or have net operating costs associated with them.

In addition to the office building leases, the Bank has two leases for ATM & night depository kiosks. The operating leases had initial terms of five years each and various renewal options of three years each.

Minimum lease commitments, before considering renewal options that generally are present, for future years are as follows:

Year ending December 31,	
2014	$ 590,000
2015	556,000
2016	536,000
2017	464,000
2018	285,000
Thereafter	41,000
	$ 2,472,000

Building and kiosk rent expense for the year ended December 31, 2013 and 2012, was approximately $564,000 and $558,000, respectively.

NOTE 8. DEPOSITS

Interest-bearing deposits consisted of the following:

	December 31, 2013	December 31, 2012
NOW accounts	$ 43,827,440	$ 38,996,807
Money Market	66,959,644	60,273,541
Time deposits $100,000 or more	41,620,304	44,083,730
Time deposits less than $100,000	19,716,026	20,234,068
Savings	22,094,816	18,307,556
	$ 194,218,230	$ 181,895,702

The scheduled maturities for all time deposits for the next 5 years were as follows:

As of December 31, 2013 and 2012, the Bank had brokered deposits totaling $0 and $1,494,000, respectively. Interest expense on time deposits of $100,000 or more was $137,012 and $153,468 in 2013 and 2012, respectively.

NOTE 9. BORROWED FUNDS

At December 31, 2013, the Bank had federal funds borrowing guidance lines with its correspondent banks in an aggregate amount of $8.0 million on an unsecured basis. In addition, the Bank has established a secured borrowing arrangement, secured by its investment portfolio, with the Federal Home Loan Bank of San Francisco ("FHLB"). As of December 31, 2013, the Bank had $100,775,250 in borrowing capacity available through the FHLB under which overnight and term advances were available. These advances are secured by assets including the Bank's ownership interest in the capital stock of the FHLB, securities and loans.

The amounts pledged at FHLB at December 31, 2013 included investment securities totaling $30,262,652 and loans totaling approximately $71,827,872. The Bank had no borrowed funds outstanding at December 31, 2013 and December 31, 2012 under these arrangements.

NOTE 10. PENSION AND OTHER POST-RETIREMENT BENEFIT PLANS

Effective October 1, 2004, the Bank established the Supplemental Executive Retirement Plan (SERP), an unfunded noncontributory defined benefit pension plan. The SERP provides retirement benefits to a select group of key executives and senior officers based on years of service and final average salary. The Bank uses December 31 as the measurement date for this Plan. The following table reflects the accumulated benefit obligation and funded status of the SERP for the years ended December 31, 2013 and 2012.

	2013	2012
Change in benefit obligation		
Beginning benefit obligation	$ 2,495,629	$ 1,941,580
Service cost	135,679	101,260
Interest cost	99,189	107,184
Actuarial (gain) loss	(288,659)	384,013
Benefits paid	(39,368)	(38,408)
Ending benefit obligation	2,402,470	2,495,629
Funded status at end of year	(2,402,470)	(2,495,629)
Unrecognized net actuarial loss	162,246	511,438
Unrecognized prior service cost	21,450	29,930
Accrued benefit cost	(2,218,774)	(1,954,261)
Accrued benefit liability	(2,402,470)	(2,495,629)
Accumulated other comprehensive income	183,696	541,368
Net amount recognized	$ (2,218,774)	$ (1,954,261)
Weighted average assumptions to determine benefit obligation as of December 31:		
Discount rate used to determine net periodic benefit cost	3.80%	5.30%
Discount rate used to determine benefit obligations	4.50%	3.80%
Future salary increases	N/A	N/A

The components of net periodic benefit cost recognized for the years ended December 31, 2013 and 2012 and net periodic benefit cost during the year ended December 31, 2014 are as follows:

	Year ended December 31,		
	2014	2013	2012
Components of net periodic benefit cost	(forecast)		
Service cost	$ 109,659	$ 135,679	$ 101,260
Interest cost	112,076	99,189	107,184
Amortization of prior service cost	8,480	8,480	8,480
Recognized plan loss	-	60,533	-
Net periodic benefit cost	$ 230,215	$ 303,881	$ 216,924

NOTE 11. EMPLOYEE BENEFIT PLANS

401(k) PLAN: All employees of the Bank are eligible to participate in the Bank's 401(k) Plan, which is a tax-deferred savings plan designed to assist employees in preparing for their retirement years. The plan allows employees to contribute to the Plan up to certain limits prescribed by the Internal Revenue Service. The Bank implemented a matching program during 2013 and matches up to 25% of the first 1% of the compensation contributed. Total expense for the year ending December 31, 2013 was $29,898.

The Bank accounts for split-dollar life insurance in accordance with ACS No. 715-60, Compensation - Nonretirement Postemployment Benefits, which requires that endorsement split-dollar life insurance arrangements which provide a postretirement benefit to an employee be recorded based on the substance of the agreement with the employee. If the employer has effectively agreed to provide the employee with a death benefit, the employer should accrue, over the service period, a liability for the actuarial present value of the future death benefit as of the employee's expected retirement date. Total (benefit) expense recognized during the year ending December 31, 2013 and December 31, 2012 was ($44,403) and $154,348, respectively.

DEFERRED COMPENSATION PLAN: A deferred compensation plan covers all directors and executive officers. Under the plan, the Bank pays each participant, or their beneficiary, the amount of fees deferred plus interest over 15 years, beginning with the individual's termination of service. As of December 31, 2013 and 2012, no directors or executives have elected deferral of fees under this plan.

NOTE 12. INCOME TAXES

The provision for income taxes is as follows for the years ended December 31, 2013 and 2012:

	2013	2012
Current expense:		
Federal	$ 1,567,297	$ 1,574,240
State	484,767	547,030
Total current	2,052,064	2,121,270
Deferred expense:		
Federal	$ (233,900)	$ (319,301)
State	(81,652)	(87,049)
Total deferred	(315,552)	(406,350)
Total provision	$ 1,736,512	$ 1,714,920

The effective tax rates differ from the federal statutory rate of 34% applied to income before income taxes due to the following for the years ended December 31, 2013 and 2012:

	Year ended December 31, 2013	2012
Federal statutory rate	34.00%	34.00%
State income tax, net of federal effect	5.27%	6.66%
Tax exempt interest	(3.48%)	(3.56%)
Bank owned life insurance	(1.17%)	(1.27%)
Split dollar expense	(0.30%)	1.15%
Other	0.08%	0.67%
Net	34.40%	37.65%

Deferred income taxes are the result of differences between income tax accounting and accounting principles generally accepted in the United States of America, with respect to income and expense recognition. The tax effects of temporary differences that gave rise to deferred tax assets and deferred tax liabilities at December 31, 2013 and 2012 are as follows:

	2013	2012
Allowance for loan losses	$ 1,978,392	$ 1,777,764
Unrealized loss on available for sale securities and pension	118,061	-
Deferred compensation	913,123	832,274
Accruals	593,074	358,922
Current state income tax	211,136	189,546
Other deferred tax assets	232,498	228,259
Gross deferred tax assets	4,046,284	3,386,765
Deferred loan costs	(726,850)	(492,612)
Unrealized gain on available for sale securities and pension	-	(239,397)
Fixed assets	(21,197)	(34,291)
Other deferred tax liabilities	(61,980)	(57,218)
Gross deferred tax liabilities	(810,027)	(823,518)
Net deferred tax asset	$ 3,236,257	$ 2,563,247

Management believes that it is more likely than not that the deferred tax assets will be realized as a result of expected continued profitability. Accordingly, no valuation allowance has been established as of December 31, 2013 or December 31, 2012.

The Bank files income tax returns in the United States and California jurisdictions. There are currently no pending federal, state, or local income tax examinations by tax authorities. Unrecognized tax benefits are not expected to significantly increase or decrease within the next twelve months. The Bank's federal and state tax returns for the years 2010 to 2013 and 2009 to 2013, respectively, are currently open for examination.

NOTE 13. RELATED PARTY TRANSACTIONS

In the ordinary course of business, the Bank makes loans to directors, officers, shareholders and their associates. At December 31, 2013 and 2012, no related party loans were on nonaccrual or classified for regulatory reporting purposes.

Loan related activity to directors, officers, and principal shareholders and their associates for the years ended December 31, 2013 and 2012 is as follows:

	2013	2012
Beginning balance	$ 925,380	$ 1,144,127
New loans or disbursements	65,866	493,653
Principal repayments	(99,884)	(712,400)
Ending balance	$ 891,362	$ 925,380

Deposits from principal officers, directors, and their affiliates at year end 2013 and 2012 were $2,065,103 and $1,432,516.

NOTE 14. STOCK BASED COMPENSATION

The Bank has two share based compensation plans as described below. Total compensation cost that has been charged against income for those plans was $91,546 and $77,655 for 2013 and 2012. The total income tax benefit recorded to additional paid in capital was $13,505 and $64,052 for 2013 and 2012, respectively.

STOCK OPTION PLAN: The Bank adopted a qualified stock option plan (the "Option Plan") for employees, non-employee directors and Bank founders, under which a maximum of 500,202 shares of Bank's common stock may be issued. The Option Plan calls for the exercise prices of the options to be equal to or greater than the fair market value of the stock at the time of grant. Options granted to Bank founders who are not also Bank directors or Bank officers were fully vested upon the date of grant. All other options shares granted have daily vesting over the first four years of the option contract. All option contracts for founders who are not also Bank directors or Bank officers have expiration dates of ten years from the date of grant. All director and employee option contracts have expiration dates on the earlier of termination of service or 10 years from the date of grant.

The Santa Cruz County Bank 2003 Stock Option Plan (the "Option Plan") permits the grant of stock options to directors, organizers and employees of the Bank. Grants of options to the organizers during the start up phase of the Bank and to the Directors are considered non-qualified stock option awards. All other option grants are considered incentive stock option awards. A group of incentive stock options for 10 employees were re-priced and exchanged in 2012 for existing vested incentive stock options under the terms of a Tender Offer.

All options granted under the Plan have a 10 year term and have been issued with exercise prices at the fair market value of the underlying shares at the date of grant. The non-qualified stock option awards to the organizers vested 100% immediately, whereas regular stock option awards to directors and employees vest over a four year period from the date the options were granted. The exchanged options were issued with an exercise price at the fair market value of the underlying shares at the date of exchange and have the same expiration date as the original grant.

There was no increase in the incremental compensation resulting from the exchanged options described above as the number of options granted was decreased to equal the incremental cost of compensation prior to the modification.

The Bank estimates the fair value of each option award as of the date of grant using a Black-Scholes-Merton option pricing formula and the following assumptions. Expected volatility is based on historical volatility of similar entities over a preceding period commensurate with the expected term of the option because the Bank's common stock has been publicly traded for a shorter period than the expected term for the options. The "simplified" method described in the Securities and Exchange Commission's Staff Accounting Bulletin No. 110 is used to determine the expected term of the options due to the lack of sufficient historical data. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant with substantially the same term as the expected term of the option. Expected dividend yield was not considered in the option pricing formula for 2013 since dividends were paid after that last options were granted during the year.

The following weighted average assumptions as of grant date used for 2013 and 2012 are as follows:

	2013	2012
Expected life (yrs.)	6.00	6.25
Volatility	49.76% - 50.79%	44.20% - 58.56%
Risk-free rate of return	0.82% - 1.52%	0.19% - 0.89%
Dividend yield	0.00	0.00

The following is a summary of the activity relating to the Bank's stock option plan for the year ended December 31, 2013 as presented below:

	December 31, 2013			
	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value
Options outstanding at beginning of year	229,670	$11.07		
Granted	36,000	$16.40		
Exercised	(32,150)	$10.28		
Forfeited or expired	-	$0.00		
Options outstanding at end of year	233,520	$12.00	2.83 years	$1,367,660
Options fully vested and expected to vest	226,588			$1,346,855
Exercisable at end of year	188,755	$11.15	1.44 years	$1,257,252

Information related to the stock option plan during the year follows:

		2013
Intrinsic value of options exercised	$	236,563
Cash received from option exercises		330,410
Tax benefit realized from option exercises		13,505
Weighted average fair value of options granted	$	7.7800

As of December 31, 2013, there was $277,419 of total unrecognized compensation cost related to nonvested stock options granted under the plan. The cost is expected to be recognized over a weighted average period of 3.17 years.

RESTRICTED STOCK AWARD PLAN: The Bank adopted a non-qualified restricted stock award plan (the "Award Plan") for executive officers and non-employee directors under which the lesser of (i) 218,390 shares or (ii) the difference between 500,202 and the sum of the number of shares underlying stock options outstanding or granted after April 11, 2011 and the number of shares of Restricted Stock Awards granted that may be issued. Restricted Stock Awards vest at 25% per year on the anniversary date of the award over the first four years of the contract, except in the event of a qualifying Terminating Event.

The following is a summary of the activity relating to the Bank's restricted stock award plan as of December 31, 2013 as presented below:

	December 31, 2013	
Nonvested Shares	Shares	Weighted Average Grant Date Fair Value
Nonvested at January 1, 2013	7,500	$11.14
Granted	-	-
Vested	(2,500)	$11.14
Forfeited	-	$0.00
Nonvested at December 31, 2013	5,000	$11.14

As of December 31, 2013, there was $37,223 of total unrecognized compensation cost related to nonvested shares granted under the plan. The cost is expected to be recognized over a weighted average period of 1.36 years. The total fair value of shares vested during the years ended December 31, 2013 was $27,862.

NOTE 15. REGULATORY CAPITAL MATTERS

REGULATORY CAPITAL: The Bank is subject to various regulatory capital adequacy requirements administered by the banking regulatory agencies. The Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) required that the federal regulatory agencies adopt regulations defining five capital tiers for depository institutions: well-capitalized, adequately capitalized, under capitalized, significantly under capitalized, and critically under capitalized. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, would have a direct material effect on the Bank's financial statements.

Quantitative measures, established by the regulators to ensure capital adequacy, require that the Bank maintain minimum ratios (set forth in the following table) of capital to risk weighted assets and average assets. Management believes that, as of December 31, 2013 and 2012, the Bank met all capital adequacy requirements to which it was subject.

The most recent notification from the FDIC categorized the Bank as well-capitalized under the FDICIA regulatory framework for prompt corrective action. To be categorized as well-capitalized, the institution must maintain a total risk-based capital ratio as set forth in the following table. At year end 2013 and 2012, the most recent regulatory notifications categorized the Bank as well-capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the institution's category.

Actual and required capital amounts (in thousands) and ratios are presented below at year end.

(Dollars in thousands)	Actual		For Capital Adequacy Purposes:		Capitalized Under the FDICIA Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2013						
Total capital (to risk weighted assets)	$ 36,860	13.00%	$ 22,690	8.00%	$ 28,363	10.00%
Tier 1 capital (to risk weighted assets)	$ 33,286	11.74%	$ 11,345	4.00%	$ 17,018	6.00%
Tier 1 capital (to average assets) leverage ratio	$ 33,286	8.21%	$ 16,225	4.00%	$ 20,282	5.00%
As of December 31, 2012						
Total capital (to risk weighted assets)	$ 33,011	13.15%	$ 20,082	8.00%	$ 25,102	10.00%
Tier 1 capital (to risk weighted assets)	$ 29,849	11.89%	$ 10,041	4.00%	$ 15,061	6.00%
Tier 1 capital (to average assets) leverage ratio	$ 29,849	8.40%	$ 14,220	4.00%	$ 17,775	5.00%

DIVIDEND RESTRICTIONS: The Board of Directors may, to the extent of such earnings and the Bank's net capital requirements and subject to the provisions of the California Financial Code, declare and pay a portion of such earnings to its shareholders as dividends.

NOTE 16. LOAN COMMITMENTS AND OTHER DISCLOSURES

RESTRICTIONS ON CASH AND DUE FROM BANKS: Santa Cruz County Bank is subject to Federal Reserve Act Regulation D, which requires banks to maintain average reserve balances with the Federal Reserve Bank. Reserve requirements are offset by usable cash reserves. The Bank had no reserve requirement at December 31, 2013 and December 31, 2012.

At times, the Bank maintains deposit amounts at corresponding banks that exceed federally insured limits. The Bank has not experienced any losses on amounts exceeding the insured limits.

LOAN COMMITMENTS: The Bank is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, standby letters of credit, overdraft protection and financial guarantees. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheets. The contract amounts of those instruments reflect the extent of involvement the Bank has in particular classes of financial instruments.

The Bank's exposure to credit loss in the event of nonperformance by the other party for commitments to extend credit, standby letters of credit, and financial guarantees is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

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

Standby letters of credit and financial guarantees written are conditional commitments issued by the Bank 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. Financial instruments whose contract amounts represent credit risk at December 31, 2013 and December 31, 2012 are as follows:

	December 31,	
	2013	2012
Commitments to extend credit	$ 86,666,270	$ 67,806,394
Standby letters of credit	684,464	2,481,630
	$ 87,350,734	$ 70,288,024

NOTE 17. EARNINGS PER SHARE

EARNINGS PER SHARE: A reconciliation of the numerators and denominators of the basic and diluted earnings per share computation is a follows:

		Net Income	Weighted Average Number of Shares		Per Share Amount
December 31, 2013					
Basic earnings per share	$	3,311,997	1,968,666	$	1.68
Effect of dilutive stock based compensation		-	77,595		
Diluted earnings per share	$	3,311,997	2,046,261	$	1.62
December 31, 2012					
Basic earnings per share	$	2,840,305	1,930,083	$	1.47
Effect of dilutive stock based compensation		-	59,203		
Diluted earnings per share	$	2,840,305	1,989,286	$	1.43

Stock options for 68,000 shares and 88,530 shares of common stock were not considered in computing diluted earnings per common share for the years ended December 31, 2013 and 2012, respectively, because they were anti-dilutive.

BOARD OF DIRECTORS

George R. Gallucci
(Chairman)
Retired Banker & Registered Investment Advisor

Harvey J. Nickelson
Retired Bank CEO & Community Volunteer

William J. Hansen
(Vice-Chairman) President & CEO Hansen Insurance Co.

Tila Guerrero
President & CEO Mas Mac Inc. & McDonald's Restaurants

Thomas N. Griffin
Director & President
Grunsky, Ebey, Farrar & Howell

Kenneth R. Chappell
CPA, Partner-In-Charge
Hutchinson & Bloodgood, LLP

David V. Heald
President & CEO
Santa Cruz County Bank

BANK FOUNDERS

A group of local business people joined to create a local, community bank focused on serving the residents and businesses of Santa Cruz County when it became apparent that the last of the local independent banks was soon to be taken over by a large out-of-area bank holding company. This group that we recognize as Founders all contributed time, money, and talent, not only to the Bank's organizing effort, but continue to be involved and support our Bank by being customers, referring family, friends and business contacts to us, and serving as ambassadors of the Bank in our community.

The Bank's Founders are listed below:

Richard Alderson
Joseph Anzalone
Victor Bogard
Anthony & Rebecca Campos
Charles Canfield
*Kenneth R. Chappell**
Kate & Fred Chen
*George R. Gallucci**
*Thomas N. Griffin**
*Tila Guerrero**
*William J. Hansen**
*David V. Heald**
Mark Holcomb
*Steven G. John***
Mateo Lettunich
Robert Lockwood
William Moncovich
Stuart Mumm
George Ow, Jr.
Louis Rittenhouse
Frank Saveria
Robert & Bjorg Yonts

SANTA CRUZ COUNTY BANK MANAGEMENT TEAM

David V. Heald, President & Chief Executive Officer
Frederick L. Caiocca, Executive Vice President, Regional Credit Manager
Mary Anne Carson, Senior Vice President, Director of Marketing & Community Relations
Susan Chandler, Senior Vice President, SBA Department Manager
Vic Davis, Senior Vice President, Chief Financial Officer
Angelo DeBernardo, Jr., Senior Vice President, Senior Lending Officer
Carol Grove, Senior Vice President, Operations Administrator
Heather LaFontaine, Senior Vice President, Risk Management Officer & Human Resources Manager
Geoffrey Loftus, Senior Vice President, Chief Credit Officer
Jaime Manriquez, Senior Vice President, Chief Technology Officer & Information Security Officer
Jon Sisk, Senior Vice President, Director Real Estate & Construction Lending
Janice Zappa, Senior Vice President, Corporate Secretary

*denotes Bank Directors, **denotes former Bank Director

SANTA CRUZ COUNTY BANK

BANKING LOCATIONS

APTOS 7775 Soquel Dr. 662.6000

CAPITOLA 819 Bay Ave. 464.5300

SANTA CRUZ 720 Front St. 457.5000

SCOTTS VALLEY 4604 Scotts Valley Dr. 461.5000

WATSONVILLE 595 Auto Center Dr. 761.7600

ADDITIONAL ATM & NIGHT DEPOSITORY LOCATIONS

DOMINICAN HOSPITAL 1555 Soquel Dr., Santa Cruz

DELUXE FOODS 783-25 Rio Del Mar Blvd., Aptos

www.sccountybank.com

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