2008 Annual Report

SANTA CRUZ
COUNTY BANK

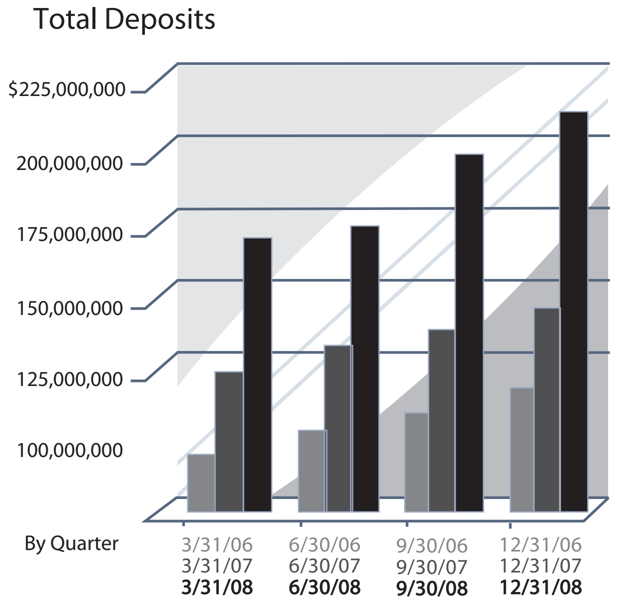
Put your money where your life is.

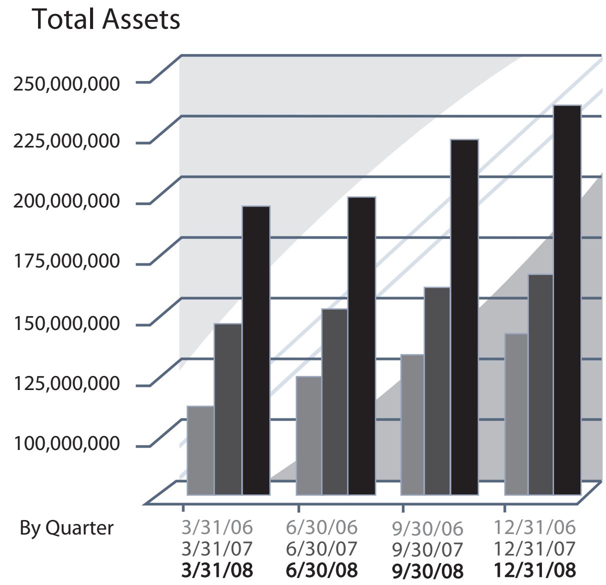
Put Your Money Where Your Life Is.

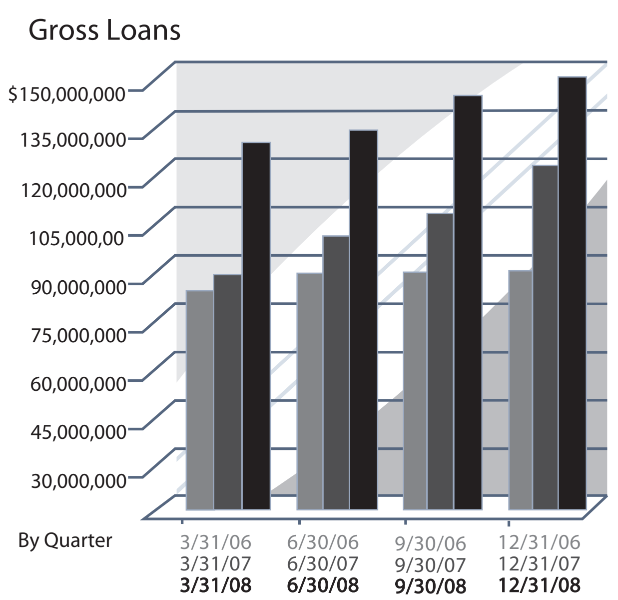
SANTA CRUZ COUNTY BANK is a locally owned and operated commercial bank, serving the needs of the residents and businesses of Santa Cruz County. We believe strongly in the importance of local decision making and responsive customer service. We offer a complete line of short and intermediate term loan products, including commercial term loans and lines of credit, U.S. Government guaranteed term loans, construction loans, commercial real estate loans and home equity lines of credit. Our deposit products are augmented by state-of-the-art services, including online banking, bill payment, cash management, merchant services, and remote deposit capture.

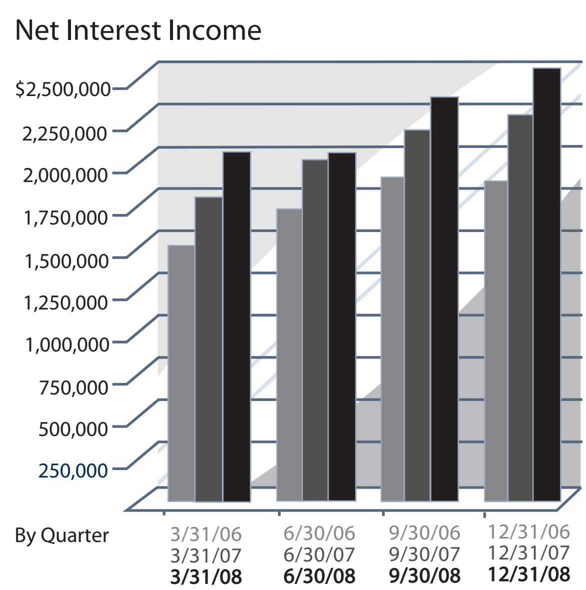
Santa Cruz County Bank operates five full service banking offices located in Aptos, Capitola, Santa Cruz, Scotts Valley, and Watsonville, a Business Lending Office on 41st Avenue in Capitola, and two free standing ATM and Night Depositories in Santa Cruz and Aptos.

QUARTERLY GROWTH 2006, 2007, 2008









To Our Shareholders, Employees, Clients, and Friends,

As we celebrate the completion of serving Santa Cruz County for five years, it is important to recognize the many individuals that have made our significant growth and progress possible: our Board of Directors and Founders whose vision was to establish a local bank to serve the needs of our community; our shareholders who provided the capital required to finance such a major undertaking; our capable management team and staff who have built our bank and who deliver our services to our community and most notably, our clients who support us by opening accounts and borrowing funds to help reach their financial goals.

To date we have achieved significant progress, meeting and in most cases exceeding our original business plan for expansion and growth. We remain focused on our mission to be the local bank of choice for individuals and businesses in our community.

There is no question that the world wide economic crisis has radically altered the financial landscape locally and nationally creating extraordinary challenges for all businesses. These challenges and problems other banks are experiencing create opportunities for a sound financial institution like ours to establish new business relationships and expand our total market share within the County. At the same time, we recognize the importance of controlling expenses and the new presentation of this report is only one example of our diligence in cutting costs wherever possible.

In recognition of its financial strength, Santa Cruz County Bank was approved by the Federal Government for $5 million in funds from its US Treasury Capital Purchase Program under “TARP” Troubled Asset Relief Program; however the Bank elected not to accept the TARP funds.

We have celebrated numerous milestones and made significant progress in executing our initiative of continued penetration and expansion of market share within the County. Outlined below are the key highlights of these milestones which have served to strengthen, grow your bank, and add shareholder value.

2008 HIGHLIGHTS

- Findley Reports, Inc., a highly regarded financial industry consulting firm, selected Santa Cruz County Bank as one of five Exceptional Banks in California based on year-end 2008 financial information.

- Santa Cruz County Bank was ranked as the #1 lender of SBA 7(a) loans in Santa Cruz County for the U.S. Small Business Administration’s (SBA) 2008 fiscal year.

- In the first and second quarter of 2008, we were awarded a “Superior” 5-Star Rating from Bauer Financial. In the third and fourth quarter of 2008, we achieved an “Excellent” 4-Star rating from Bauer Financial.

- As of June 30, 2008 the Bank’s market share of deposits in the County of Santa Cruz increased to 4.15% from 2.97% in the prior year.

- The Bank has been awarded Green Business Certifications by the Monterey Bay Area Green Business Association for its dedication to environmental practices in every location we operate, which includes five full service branches, a Business Lending office and our Administrative offices.
- In July 2008 we relocated our Santa Cruz office to the downtown area, resulting in $10 million in deposit growth in the first 8 months.
- Throughout 2008 we introduced new products which responded to the needs of existing clients and attracted new clients: Health Savings Accounts (H.S.A.'s), H.S.A. Debit Cards, and Business Debit Cards.
- In the third quarter of 2008, we surpassed $200 million in assets.
- In the fourth quarter of 2008, we surpassed $200 million in total deposits.
- In the Fourth Quarter of 2008, we announced for the fourth consecutive year double-digit percentage increases (year to year) in total deposits, gross loans and total assets.

These milestones are a reflection of the capabilities, knowledge, and commitment of Santa Cruz County Bank's management team, as well as our reputation in the community as the local bank of choice. These achievements would not be possible without the loyalty and support from you, our clients, our shareholders, and our community, as well as our dedicated family of employees.

2009 AND BEYOND

In the first quarter of 2009 we celebrated the Bank's 5th Anniversary of service to Santa Cruz County and the opening of our fifth full service banking office, located in Aptos. Our lobbies, filled with balloons, coffee and cookies during our Anniversary, served to thank the community for its support of the growth of its local bank.

We encourage you to visit any of our five full service offices and our Business Lending Office to discover an extremely friendly, unique, and refreshing banking experience. You will see art on our walls, smiling faces, and experience our commitment to customer service. Our number one focus remains to serve our clients and our community.

We value your support and relationship with Santa Cruz County Bank.

George Gallucci	David Heald
Chairman of the Board	President & CEO

The Board of Directors
Santa Cruz County Bank

We have audited the balance sheets of Santa Cruz County Bank as of December 31, 2008, and 2007 and the related statements of operations, changes in stockholders' equity and other comprehensive income, and cash flows for the years then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

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

Vavrinek Trine Day + Co. LLP

Palo Alto, California
April 6, 2009

SANTA CRUZ COUNTY BANK

STATEMENTS OF CONDITION
December 31, 2008 and 2007

	December 31, 2008	Restated 2007
ASSETS		
Cash and due from banks	$ 6,001,390	$ 6,129,861
Interest bearing deposits in other financial institutions	2,935	4,632
Federal funds sold	7,990,213	6,574,261
Total cash and cash equivalents	13,994,538	12,708,754
Certificates of deposit in other financial institutions	30,877,500	1,000,000
Investment securities:		
Securities held to maturity	846,963	1,048,149
Securities available for sale, at estimated fair value	30,745,169	19,900,590
Total investment securities	31,592,132	20,948,739
Bankers' Bank stock, at cost	774,400	619,600
Loans receivable:		
Gross loans	146,106,831	119,226,597
less deferred loan fees, net of costs	22,158	269,164
less reserve for loan losses	2,885,298	1,788,000
Net loans	143,199,375	117,169,433
Premises and equipment, net	2,025,918	1,570,471
Accrued interest receivable	764,060	672,218
Bank owned life insurance	3,596,558	3,460,653
Deferred income tax	1,641,087	956,805
Other assets	634,517	1,056,075
TOTAL ASSETS	$ 229,100,085	$ 160,162,748
LIABILITIES AND SHAREHOLDERS' EQUITY		
LIABILITIES		
Non-interest bearing demand deposits	$ 63,386,131	$ 44,200,647
Interest bearing demand deposits	12,927,077	8,598,091
Savings and money market deposits	68,630,762	53,739,693
Time deposits	62,252,416	32,470,437
Total deposits	207,196,386	139,008,868
Accrued interest payable	362,929	512,511
Other liabilities	2,552,796	1,560,618
Total liabilities	210,112,111	141,081,997
SHAREHOLDERS' EQUITY		
Common stock, no par value, 30,000,000 shares authorized; and December 31, 2007	18,574,863	18,574,863
Additional paid-in-capital	446,074	372,454
Retained earnings	111,649	94,473
Accumulated other comprehensive income (loss)	(144,612)	38,961
Total Shareholders' equity	18,987,974	19,080,751
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 229,100,085	$ 160,162,748

See accompanying notes to the financial statements

SANTA CRUZ COUNTY BANK

STATEMENTS OF OPERATIONS
For the years ended December 31, 2008 and 2007

	Year Ended December 31, 2008	Year Ended December 31, 2007
INTEREST INCOME:		
Interest and fees on loans	$ 9,320,223	$ 8,856,093
Investment securities	1,472,111	979,935
Federal funds sold and other interest income	661,363	1,028,629
Total interest income	11,453,697	10,864,657
INTEREST EXPENSE:		
Deposits and other borrowed funds	2,775,843	2,908,202
Net interest income before provision for loan losses	8,677,854	7,956,455
Provision for loan losses	1,676,176	512,000
Net interest income after provision for loan losses	7,001,678	7,444,455
NON-INTEREST INCOME:		
Service charges on deposit accounts	406,482	279,221
Other non-interest income	1,049,412	851,056
Total non-interest income	1,455,894	1,130,277
NON-INTEREST EXPENSE:		
Salaries and employee benefits	4,970,994	4,266,507
Occupancy	735,282	569,577
Furniture and equipment	434,321	368,223
Marketing and business development	302,180	278,098
Item and data processing	319,148	238,238
Professional services	221,424	247,231
Other operating expenses	1,450,104	894,382
Total non-interest expense	8,433,453	6,862,256
Income before income taxes	24,119	1,712,476
Income tax expense	6,943	732,254
Net income	$ 17,176	$ 980,222
EARNINGS PER SHARE - BASIC	$ 0.01	$ 0.59
EARNINGS PER SHARE - DILUTED	$ 0.01	$ 0.56

See accompanying notes to the financial statements

SANTA CRUZ COUNTY BANK

STATEMENT OF SHAREHOLDERS' EQUITY
For the years ended December 31, 2008 and 2007

	Common Shares	Amount	Additional Paid In Capital	Retained Earnings	Other Comprehensive (Loss) Income	Total Shareholders' Equity
Balance at December 31, 2006 (Restated)	1,648,374	$ 18,429,623	$ 198,342	$ (885,749)	$ (159,708)	$ 17,582,508
Exercise of stock options	13,966	145,240	-			145,240
Stock-based compensation			174,112			174,112
Net income				980,222		980,222
Tax benefit from exercise of non-qualified stock options			-			-
Amortization of pension cost FAS158					46,534	46,534
Unrealized gain on securities available for sale, net of tax of $48,999					152,135	152,135
Balance at December 31, 2007	1,662,340	18,574,863	372,454	94,473	38,961	19,080,751
Stock-based compensation			73,620			73,620
Split dollar liability adjustment					(341,199)	(341,199)
Net income				17,176		17,176
Amortization of pension cost FAS158					14,869	14,869
Unrealized gain on securities available for sale, net of tax of $62,406					142,757	142,757
Balance at December 31, 2008	1,662,340	$ 18,574,863	$ 446,074	$ 111,649	$ (144,612)	$ 18,987,974

See accompanying notes to the financial statements

SANTA CRUZ COUNTY BANK

STATEMENTS OF CASH FLOWS
For the years ended December 31, 2008 and 2007

	Year Ended December 31, 2008	Year Ended December 31, 2007
OPERATING ACTIVITIES:		
Net income	$ 17,176	$ 980,222
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Deferred income tax (benefit)	(313,614)	(293,966)
Depreciation and amortization of premises and equipment	445,826	387,572
Accretion of discounts, net of amortization for investments	(21,907)	(38,731)
Net other amortization and accretion	6,300	138,437
Provision for loan losses	1,676,176	512,000
Increase in cash value of bank owned life insurance	(135,905)	(128,682)
Loss on sale/disposal of assets	98,965	-
Stock-based compensation	73,620	174,112
Deferred benefit expense	307,660	-
Increase (decrease) in accrued interest receivable	(91,842)	40,409
Increase (decrease) in deferred loan fees, net of costs	(247,006)	23,741
Increase (decrease) in other assets	379,281	(80,947)
Increase (decrease) in accrued interest payable	(149,582)	110,967
Increase (decrease) in other liabilities	(74,886)	166,467
Net cash provided by operating activities	1,571,783	1,642,260
INVESTING ACTIVITIES:		
Held-to-maturity securities:		
Principal repayments	199,094	212,709
Available-for-sale securities:		
Maturities/Calls	20,714,286	16,225,000
Principal repayments	2,642,865	656,452
Purchases	(33,972,568)	(17,913,988)
Increase in certificates of deposit in other financial institutions	(29,877,500)	(1,000,000)
Increase in Federal Home Loan Bank stock	(154,800)	(102,700)
Purchase of Pacific Coast Bankers' Bank stock	-	(170,000)
Net proceeds from sales of loans	6,918,591	4,016,839
Net increase in loans	(33,943,247)	(40,339,885)
Purchase of premises and equipment	(1,016,938)	(606,468)
Proceeds from sale of assets	16,700	8,571
Net cash used by investing activities	(68,473,517)	(39,013,470)
FINANCING ACTIVITIES:		
Net proceeds from sale of common stock	-	145,240
Increase in demand deposits	23,514,470	12,721,852
Increase in savings and money market deposits	14,891,069	8,760,487
Increase in time deposits	29,781,979	4,544,986
Net cash provided by financing activities	68,187,518	26,172,565
Net increase (decrease) in cash and cash equivalents	1,285,784	(11,198,645)
Cash and cash equivalents at beginning of period	12,708,754	23,907,399
Cash and cash equivalents at end of period	$ 13,994,538	$ 12,708,754
Supplemental Disclosures of Cash Flow Information		
Total interest paid	$ 3,032,917	$ 2,797,235
Total income taxes paid	529,000	788,270

See accompanying notes to the financial statements

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of the Business

Santa Cruz County Bank (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 Financial Institutions ("DFI") and the Federal Deposit Insurance Corporation ("FDIC"). The Bank's deposits are insured by the FDIC up to applicable limits. The Bank is subject to competition from other financial institutions.

The majority of the Bank's business is conducted with customers located in Northern California, specifically in Santa Cruz and adjacent counties. The Bank has 337 credit arrangements that are collateralized by real estate. Generally, the Bank maintains loan-to-value ratios no greater than 70 percent on commercial and multi-family real estate loans and no greater than 75 percent on single-family residential real estate loans. At December 31, 2008, the Bank had loans outstanding of approximately $106,733,000 that were collateralized by real estate. There were no other significant loan concentrations.

Summary of Significant Accounting Policies

The accounting and reporting policies of the Bank conform to generally accepted accounting principles in the United States of America ("GAAP") and prevailing practices within the banking industry. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported accounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The following is a summary of significant policies used in the preparation of the accompanying consolidated financial statements.

Cash and Cash Equivalents: For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, interest bearing deposits in other financial institutions and federal funds sold. Federal funds are sold for a one day period and are highly liquid investments.

Investment Securities: Marketable investment securities consist of U.S. Government Agency bonds and mortgage-backed securities, tax free general obligation municipal bonds and corporate trust preferred. 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 does not engage in securities trading activities.

Held to maturity securities are recorded at amortized cost, adjusted for amortization or accretion of premiums or discounts. Available for sale securities are recorded at fair value with unrealized holding gains and losses, net of the related tax effect, reported as a separate component of shareholders' equity until realized. During the year ended December 31, 2008, there were no transfers between classifications. Premiums and discounts are amortized or accreted over the life of the related security as an adjustment to yield using the interest method, except for securities with early call provisions, in which case premiums are recognized in interest income using the interest method over the period to the first call date and discounts are recognized in interest income using the interest method over the period to the contractual maturity date. Dividend and interest income are recognized on an accrual basis. Realized gains and losses for securities classified as available for sale and held to maturity are included in earnings and are derived using the specific identification method for determining the cost of securities sold.

Securities are evaluated for impairment periodically. A decline in the market value of any available for sale security below cost deemed other than temporary, results in a charge to earnings and the establishment of a new cost basis for the security. No such declines have occurred.

Loans: Loans are stated at the amount of unpaid principal, net of deferred loan fees, and reduced by the allowance for loan losses. 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 loans are well-secured and in the process of collection. When a loan is placed on non-accrual status, all interest previously accrued but not collected is reversed from current period income. Income on such loans is then recognized only to the extent that cash is received and where the future collection of principal is probable.

Generally, a non-accrual loan will be restored to an accrual status when none of its principal and interest is past due, when prospects for future contractual payments are no longer in doubt and when the loan becomes well-secured and in the process of collection. The Bank did not have any non-accrual loans at December 31, 2008 or December 31, 2007.

In accordance with SFAS No. 114, a loan is considered 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, including scheduled interest payments. Generally, the Bank identifies loans to be reported as impaired when such loans are in non-accrual status or are considered troubled debt restructurings due to the granting of a below-market rate of interest or a partial forgiveness of indebtedness on an existing loan. If the measurement of the impaired loans is less than the recorded investment in the loan, impairment is recognized by creating a specific loss allocation to the allowance for loan losses to adjust the loan to fair value.

Non-refundable fees and estimated loan origination costs are deferred net and are amortized to income over the expected life of the loan using a method that approximates the level yield method.

Loans Held for Sale: The Bank has adopted SFAS No. 140, *"Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities."* The statement provides accounting and reporting standards for transfers and servicing of financial assets and extinguishments of liabilities. Under this Statement, after a transfer of financial assets, an entity recognizes the financial and servicing assets it controls and liabilities it has incurred, derecognizes financial assets when control has been surrendered, and derecognizes liabilities when extinguished.

To calculate the gain (loss) on the sale of loans, the Bank's investment in the loan is allocated among the retained portion of the loan, the servicing retained, the interest-only strip and the sold portion of the loan, based on the relative fair market value of each portion. The gain (loss) on the sold portion of the loan is recognized at the time of sale based on the difference between the sale proceeds and the allocated investment. As a result of the relative fair value allocation, the carrying value of the retained portion is discounted, with the discount accreted to interest income over the life of the loan. That portion of the excess servicing fees that represent contractually specified servicing fees (contractual servicing) are reflected as a servicing asset which 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.

Allowance for Loan Losses: The allowance for loan losses is established through periodic provisions for possible loan losses. Loans are charged against the allowance for loan losses when management believes that the principal is unlikely to be recovered. The allowance is a reserve to provide for possible losses on existing loans that may become uncollectible, based on evaluations of the loan portfolio and prior loan loss experience. The evaluations include consideration of changes in the nature and volume of the loan portfolio, overall portfolio quality, the review of specific problem loans, and current economic conditions that may affect the borrowers' ability to pay.

Management believes that the allowance for loan losses is adequate. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in economic conditions. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance for loan losses. Such agencies may require the Bank to recognize additions to the allowance based on their judgment of information available to them at the time of their examination.

The Bank’s Directors’ Loan Committee reviews the adequacy of the allowance for loan losses at least quarterly.

Servicing Rights: Servicing rights are recognized separately when they are acquired through sale of loans. For sales of SBA loans prior to January 1, 2007, a portion of the cost of the loan was allocated to the servicing right based on relative fair values. The Bank adopted SFAS No. 156, Accounting for Servicing of Financial Assets, on January 1, 2007, for sales of SBA loans beginning in 2007. Servicing rights are initially recorded at fair value with the income statement effect recorded in gain on sale of loans. Fair value is based on a valuation model that calculates the present value of estimated future cash flows from the servicing assets. The valuation model uses assumptions that market participants would use in estimating cash flows from servicing assets, such as the cost to service, discount rates and prepayment speeds. The Bank compares the valuation model inputs and results to published industry data in order to validate the model results and assumptions. All classes of servicing assets are subsequently measured using the amortization method which requires servicing rights to be amortized into noninterest income in proportion to, and over the period of, the estimated future net servicing income of the underlying loans.

Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to the carrying amount. Impairment is determined by stratifying rights into groupings based on predominant risk characteristics, such as interest rate, loan type and investor type. For purposes of measuring impairment, the Bank has identified each servicing asset with the underlying loan being serviced. A valuation allowance is recorded where the fair value is below the carrying amount of the asset. 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. The fair values of servicing rights are subject to significant fluctuations as a result of changes in estimated and actual prepayment speeds and changes in the discount rates.

Servicing fee income which is reported on the income statement as servicing income is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal and recorded as income when earned. The amortization of servicing rights and changes in the valuation allowance are netted against loan servicing income.

Premises & Equipment: Premises and equipment are stated at cost less accumulated depreciation and amortization and include additions that materially extend the useful lives of existing premises and equipment. All other maintenance and repair expenditures are expensed as incurred.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, three to seven years, and are expensed to non-interest expense. Leasehold improvements are amortized over their estimated useful lives, seven years or the initial term of the respective leases, whichever is longer. 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 lease term. Gains and losses on disposition of premises and equipment are accounted for under the specific identification method.

Income Taxes: 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. 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.

On January 1, 2007, the Bank adopted Financial Accounting Standards Board ("FASB") Interpretation No. 48, Accounting for Uncertainty in Income Taxes ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes. FIN 48 prescribes a recognition threshold and measurement standard for the financial statement recognition and measurement of an income tax position taken or expected to be taken in a tax return. In addition, FIN 48 provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

The provisions of FIN 48 have been applied to all tax positions of the Bank as of January 1, 2007. Only tax positions that met the more-likely-than-not recognition threshold on January 1, 2007 were recognized or continue to be recognized upon adoption. The Bank previously recognized income tax positions based on management's estimate of whether it was reasonably possible that a liability has been incurred for unrecognized income tax benefits by applying FASB Statement No. 5, Accounting for Contingencies. The adoption of FIN 48 did not have a material impact on the Bank's financial position, results of operations or cash flows. The adoption of FIN 48 made no impact on the balance of retained earnings as of January 1, 2007.

Interest expense associated with unrecognized tax benefits is classified as income tax expense in the statement of income. Penalties associated with unrecognized tax benefits are classified as income tax expense in the statement of income.

Stock-Based Compensation: On January 1, 2006, the Bank implemented SFAS No. 123 (revised 2004) (SFAS No. 123R), Share-Based Payments, which addresses the accounting for stock-based payment transactions in which an enterprise receives employee services in exchange for (a) equity instruments of the enterprise or (b) liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. SFAS No. 123R eliminates the ability to account for stock-based compensation transactions using the intrinsic value method under Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, and instead generally requires that such transactions be accounted for using a fair-value-based method. The Bank uses the Black-Scholes-Merton ("BSM") option-pricing model to determine the fair value of stock-based awards under SFAS No. 123R, consistent with that used for pro forma disclosures under SFAS No. 123, Accounting for

Stock-Based Compensation. The Bank has elected the modified prospective transition method as permitted by SFAS No. 123R and accordingly prior periods have not been restated to reflect the impact of SFAS No. 123R. The modified prospective transition method requires that stock-based compensation expense be recorded for all new and unvested stock options, restricted stock, restricted stock units, and employee stock purchase plan shares that are ultimately expected to vest as the requisite service is rendered beginning on January 1, 2006, the first day of the Bank's fiscal year 2006. Stock-based compensation expense for awards granted prior to January 1, 2006 is based on the grant date fair value as determined under the pro forma provisions of SFAS No. 123. During 2008 and 2007, the Bank recorded pre-tax stock based compensation expense of $73,620 and $174,112, respectively, as a result of the adoption of SFAS No. 123R. For the years ended December 31, 2008 and 2007, the impact of implementing SFAS No. 123R reduced basic earnings per share by $.04 and $.09, respectively, and diluted earnings per share by $0.04 and $0.08, respectively.

No stock-based compensation costs were capitalized as part of the cost of an asset as of December 31, 2008. As of December 31, 2008, $188,000 of total unrecognized compensation cost related to stock options is expected to be recognized over a weighted-average period of 4 years.

Earnings Per Share: SFAS No. 128, *Measurement of Earnings per Share*, establishes standards for computing and reporting basic earnings per share and diluted earnings per share. Basic earnings per share are calculated by dividing net earnings for the period by the weighted-average common shares outstanding for that 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. The following table summarizes the weighted average shares outstanding used to compute earnings per share:

	Year ended December 31, 2008	Year ended December 31, 2007
Net Income, as reported	$ 17,176	$ 980,222
Earnings per share, basic	$ 0.01	$ 0.59
Earnings per share, diluted	$ 0.01	$ 0.56
Weighted average shares outstanding, basic	1,662,340	1,653,017
Weighted average shares outstanding, diluted	1,689,927	1,737,325

Comprehensive Income: SFAS No. 130, "Reporting Comprehensive Income" requires that all items recognized under accounting standards as components of comprehensive earnings be reported in an annual financial statement that is displayed with the same prominence as other annual financial statements. This Statement also requires that an entity classify items of other comprehensive earnings by their nature in the annual financial statements. Other comprehensive earnings include the SFAS No. 158 adjustment to fully recognize the liability associated with the supplemental executive retirement plan and unrealized gains and losses, net of tax, on marketable securities classified as available for sale. The Bank had accumulated other comprehensive losses, net of tax of $144,612 at December 31, 2008, and accumulated other comprehensive income, net of tax, of $38,961 at December 31, 2007.

	Year ended December 31, 2008	2007
Net income	$ 17,176	$ 980,222
Split dollar liability adjustment	(341,199)	-
Amortization of pension cost - FAS158	14,869	46,534
Unrealized gain (loss) on securities available for sale	142,757	152,135
Total comprehensive income (loss)	$ (166,397)	$ 1,178,891

Disclosure About Fair Value of Financial Instruments: SFAS No. 107 specifies the disclosure of the estimated fair value of financial instruments. The Bank's estimated fair value amounts have been determined by the Bank using available market information and appropriate valuation methodologies.

However, 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.

Restatement

The Supplemental Executive Retirement Plan (SERP) liability is actuarially determined annually by the Bank's outside pension consultants. As a result of a change in consultants for the 2008 fiscal year, the new actuary provided a recalculated balance of the SERP liability for both current and prior periods. The restated liability had no impact on previously reported net income for 2007, but did increase the ending balance of previously reported stockholders' equity for both December 31, 2006 and December 31, 2007 by $109,001. The affected accounts in stockholders' equity were retained earnings and other comprehensive income. See Note 12.

Recent Accounting Announcements

Fair Value Measurements: In September 2006, the Financial Accounting Standards Board issued SFAS No. 157, "Fair Value Measurement", a standard that provides enhanced guidance for using fair value to measure assets and liabilities. The standard also responds to investors' requests for expanded information about the extent to which a company measures assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. The standard applies whenever other standards require (or permit) assets or liabilities to be measured at fair value. Under the standard, fair value refers to the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the market in which the reporting entity transacts. The standard clarifies that fair value should be based on the assumptions market participants would use when pricing the asset or liability. In support of this principle, the standard establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. The fair value hierarchy gives the highest priority to quoted prices in active markets and the lowest priority to unobservable data, for example, the reporting entity's own data. Under the standard, fair value measurements would be separately disclosed by level within the fair value hierarchy. We adopted SFAS No. 157 on January 1, 2008, and the adoption of SFAS No. 157 did not have a material impact on our financial condition or operating results.

Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements: In September 2006, the FASB Emerging Issues Task Force (EITF) finalized Issue No. 06-4, Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements. This issue requires that a liability be recorded during the service period when a split-dollar life insurance agreement continues after participants' employment or retirement. The required accrued liability is based on the post-employment benefit cost for the continuing life insurance. This issue was effective for fiscal years beginning after December 15, 2007. We adopted the provisions of EITF 06-4 effective January 1, 2008. The impact of adoption was to reflect an additional beginning liability of $341,199, along with a corresponding charge to Accumulated Other Comprehensive Income. The current year expense for fiscal 2008 resulting from the adoption of this statement was $56,010. The charges resulting from the adoption of this EITF are not tax affected.

The Fair Value Option for Financial Assets and Financial Liabilities –Including an amendment of FASB Statement No. 115: In February 2007, the Financial Accounting Standards Board issued SFAS No. 159, "The Fair Value Option for Financial Assets and Liabilities" – Including an amendment of FASB No. 115. This Standard permits, but does not require, entities to chose to measure many financial instruments and certain other times at fair value. The Statement was intended to expand the use of fair value measurement, which is consistent with the Board's long-term measurement objectives for accounting for financial instruments. The Statement was effective for fiscal years beginning after November 15, 2007. We did not adopt any of the fair value measurement options afforded by this Statement.

Accounting for Business Combinations: In December 2007, the FASB issued SFAS No. 141 (revised 2007), Business Combinations (SFAS 141(R)), which establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in an acquiree, including the recognition and measurement of goodwill acquired in a business combination. SFAS No. 141(R) is effective for fiscal years beginning on or after December 15, 2008. Earlier adoption is prohibited. The adoption of this standard is not expected to have any material effect on the Bank's results of operations or financial position.

Noncontrolling Interests in Consolidated Financial Statements—an amendment of ARB No. 51: In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interest in Consolidated Financial Statements, and Amendment of ARB No. 51, which will change the accounting and reporting for minority interests to be recharacterized as noncontrolling interests and classified as a component of equity within the consolidated balance sheets. SFAS No. 160 is effective as of the beginning of the first fiscal year beginning on or after December 15, 2008. Earlier adoption is prohibited. The adoption of this standard is not expected to have a material effect on the Bank's results of operations or financial position.

Disclosures about Derivative Instruments and Hedging Activities—an amendment of FASB Statement No. 133: In March 2008, the FASB issued SFAS No. 161, Disclosures About Derivative Instruments and Hedging Activities, an Amendment of SFAS No. 133. SFAS No. 161 amends and expands the disclosure requirements of SFAS No. 133 for derivative instruments and hedging activities. SFAS No. 161 requires qualitative disclosure about objectives and strategies for using derivative and hedging instruments, quantitative disclosures about fair value amounts of the instruments and gains and losses on such instruments, as well as disclosures about credit-risk features in derivative agreements. SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. The Bank currently does not engage in hedging activities; and therefore, the adoption of this standard will have no material effect on the Bank's result of operations or financial position.

Reclassifications

Certain reclassifications have been made in the 2007 financial statements to conform to the presentation used in 2008. These reclassifications had no impact on the Bank's previously reported financial statements.

NOTE 2. INVESTMENT SECURITIES

The following table summarizes the carrying amount and the approximate fair values of Santa Cruz County Bank's securities held to maturity and available for sale at December 31, 2008, and December 31, 2007. "U.S. Agency" refers to the Federal National Mortgage Association ("FNMA"), the Federal Home Loan Mortgage Corporation ("FHLMC"), Federal Home Loan Bank ("FHLB") and Federal Farm Credit Bank ("FFCB"). Mortgage-backed securities are labeled as "MBS."

December 31, 2008	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Securities available for sale:				
U.S. Agency Securities	$ 7,453,215	$ 78,757	$ -	$ 7,531,972
U.S. Agency MBS's	20,632,417	475,647	-	21,108,064
Municipal	1,506,098	-	(109,695)	1,396,403
Corporate	825,778	-	(117,048)	708,730
Total securities available for sale	$ 30,417,508	$ 554,404	$ (226,743)	$ 30,745,169
Securities held to maturity:				
U.S. Agency MBS's	846,963	10,298	-	857,261
Total securities held to maturity	$ 846,963	$ 10,298	$ -	$ 857,261

December 31, 2007	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Securities available for sale:				
U.S. Agency Securities	$ 8,996,680	$ 59,510	$ (620)	$ 9,055,570
U.S. Agency MBS's	10,781,412	80,780	(17,172)	10,845,020
Total securities available for sale	$ 19,778,092	$ 140,290	$ (17,792)	$ 19,900,590
Securities held to maturity:				
U.S. Agency MBS's	1,048,149	-	(20,179)	1,027,970
Total securities held to maturity	$ 1,048,149	$ -	$ (20,179)	$ 1,027,970

The amortized cost and estimated fair value of investment securities at December 31, 2008 and December 31, 2007, by contractual maturity, are shown in the following table, except for mortgage-backed securities and other securities which are presented in total. Expected maturities may differ from contractual maturities because borrowers may have the option to prepay principal and rights of issuers to call obligations prior to maturity with or without prepayment penalties.

	Securities available for sale		Securities held to maturity	
December 31, 2008	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due after one year through five years	$ 1,999,140	$ 2,011,182	$ -	$ -
Due after five years through ten years	6,171,470	6,208,115	-	-
Due after ten years	1,614,481	1,417,807	-	-
Mortgage-backed securities	20,632,417	21,108,065	846,963	857,261
Total	$ 30,417,508	$ 30,745,169	$ 846,963	$ 857,261

	Securities available for sale		Securities held to maturity	
December 31, 2007	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due after one year through five years	$ 1,999,605	$ 2,012,190	$ -	$ -
Due after five years through ten years	5,997,075	6,043,380	-	-
Mortgage-backed securities	9,795,700	9,859,308	1,048,149	1,027,970
Total	$ 17,792,380	$ 17,914,878	$ 1,048,149	$ 1,027,970

Investment securities in a temporary unrealized loss position as of December 31, 2008 are shown in the following table, based on the time they have been continuously in an unrealized loss position:

	Less than Twelve Months		Over Twelve Months		Total Unrealized Losses	
December 31, 2008:	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses
Securities available for sale:						
Municipal	$ 1,396,403	$ (109,697)	$ -	$ -	$ 1,396,403	$ (109,697)
Corporate	708,730	(117,048)	-	-	708,730	(117,048)
	$ 2,105,133	$ (226,745)	$ -	$ -	$ 2,105,133	$ (226,745)

No investment securities were sold in 2008 or 2007. Investment securities pledged to secure public deposits or for other purposes, required or permitted by law, at December 31, 2008 and December 31, 2007, were $25,679,135 and $4,966,685, respectively.

NOTE 3. LOANS RECEIVABLE

Loan maturity and rate sensitivity data of the loan portfolio, in thousands, at December 31, 2008 and 2007 are as follows:

December 31, 2008	Within One Year	One to Five Years	After Five Years	Total
Real estate and construction	$ 30,501	$ 10,462	$ 24,858	$ 65,821
Consumer, other	17,164	1,420	125	18,709
Commercial and revolving lines	44,747	15,889	941	61,577
	$ 92,412	$ 27,771	$ 25,924	$ 146,107
Loans at fixed interest rates	$ 27,733	$ 21,349	$ 24,789	$ 73,871
Loans at variable interest rates	64,679	6,422	1,135	72,236
	$ 92,412	$ 27,771	$ 25,924	$ 146,107
December 31, 2007				
Real estate and construction	$ 32,564	$ 4,277	$ 23,637	$ 60,478
Consumer, other	12,673	254	28	12,955
Commercial and revolving lines	35,299	4,338	6,157	45,794
	$ 80,536	$ 8,869	$ 29,822	$ 119,227
Loans at fixed interest rates	$ 5,054	$ 8,297	$ 22,297	$ 35,648
Loans at variable interest rates	75,482	572	7,525	83,579
	$ 80,536	$ 8,869	$ 29,822	$ 119,227

Changes in the allowance for loan losses are as follows:

	December 31, 2008	2007
Balance at beginning of year	$ 1,788,000	$ 1,276,000
Provision for loan losses	1,676,176	512,000
Loan charge-offs	603,218	79,117
Recoveries of loan charge-offs	24,340	79,117
Balance at year end	$ 2,885,298	$ 1,788,000

In general, the Bank would not recognize any interest income on loans that are classified as impaired. The following is a summary of the investments in impaired loans, including the related allowance for loan losses and cash-basis income recognized and loans on non-accrual and those that are past due and still accruing interest as of December 31:

	2008	2007
Impaired Loans:		
Recorded investment in impaired loans	$ -	$ -
Related allowance for loan losses	$ -	$ -
Average recorded investment in impaired loans	$ 1,530,147	$ 32,000
Interest income recognized for cash payments while impaired	$ -	$ -
Total loans on non-accrual	$ -	$ -
Total loans past due 90 days or more and still accruing interest	$ 328,207	$ 286,000

NOTE 4. 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, 2008 and December 31, 2007:

	December 31, 2008	December 31, 2007
Leasehold improvements	$ 1,559,282	$ 1,211,853
Furniture, fixtures and equipment	1,373,491	1,185,550
Software and capitalized data & item processing	153,306	113,664
Computer equipment	357,949	283,301
Construction-in-progress	29,851	20,110
Total premises and equipment	3,473,879	2,814,478
Less accumulated depreciation and amortization	(1,447,961)	(1,244,007)
Premises and equipment, net	$ 2,025,918	$ 1,570,471

Depreciation expense aggregated $446,000 for the year ended December 31, 2008 and $387,000 for the year ended December 31, 2007.

NOTE 5. TIME DEPOSITS

The aggregate amount of time deposit accounts equal to or greater than $100,000 was approximately $46,880,000 and $21,815,000 at December 31, 2008 and December 31, 2007, respectively. At December 31, 2008 the scheduled maturities for all time deposits were as follows:

(Rounded to the nearest thousand)

	2008
Due in 2009	$ 61,424
Due in 2010	656
Due in 2011	162
Due in 2012	-
Due in 2013	10
	$ 62,252

Interest expense on time deposits of $100,000 or more was $867,602 and $868,072 in 2008 and 2007, respectively.

NOTE 6. INCOME TAXES

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, 2008 and 2007are as follows:

	2008	2007
Deferred pre-opening costs plus NOL's	$ 3,000	$ 44,000
Fixed assets	(177,000)	(38,000)
Allowance for loan losses	1,083,000	481,000
Accruals	553,000	451,000
State income tax	-	204,000
Other	16,000	23,000
	1,478,000	1,165,000
Valuation allowance	-	-
Net deferred tax asset	$ 1,478,000	$ 1,165,000

Offsetting the above deferred tax asset, the Bank has additional net deferred tax liabilities arising from adjustments to other comprehensive income aggregating $97,587 as of December 31, 2008.

The provision for income taxes is as follows for the years ended December 31:

	2008	2007
Current:		
Federal	$ 213,695	$ 790,447
State	106,862	235,773
Total current	320,557	1,026,220
Deferred:		
Federal	$ (182,004)	$ (222,661)
State	(131,610)	(71,305)
Total deferred	(313,614)	(293,966)
Total provision (credit)	$ 6,943	$ 732,254

The effective tax rate differs from the federal statutory rate as follows for the years ended December 31, 2008 and 2007:

	Year ended December 31, 2008	Year ended December 31, 2007
Federal statutory rate	34.00%	34.00%
State income tax, net of federal effect	7.10%	6.31%
Stock based compensation	126.90%	2.42%
Bank owned life insurance	(233.20%)	(2.56%)
Split dollar expense	96.00%	0.00%
Other	(2.00%)	(0.23%)
Net	28.80%	39.94%

Income tax returns for the years ended December 31, 2007, 2006 and 2005 and for the years ended December 31, 2007, 2006, 2005 and 2004 are open to audit by the federal and California authorities, respectively. Unrecognized tax benefits are not expected to significantly increase or decrease within the next twelve months.

NOTE 7. BORROWED FUNDS

The Bank has obtained federal funds borrowing guidance lines with its correspondent banks in an aggregate amount of $9.0 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, in an amount equal to approximately 95% of the fair market value of the Bank's investment securities portfolio pledged for borrowing. The Bank recognized less than one thousand of borrowing expense in 2008 and 2007. The Bank had no borrowed funds at December 31, 2008 and at December 31, 2007. As of December 31, 2008, the Bank had an available line of credit with the Federal Home Loan Bank of San Francisco ("FHLBSF") secured by the assets of the Bank. Under this line, the Bank may borrow up to $32,565,000 subject to providing adequate collateral and continued compliance with the Advances and Security Agreement and other eligibility requirements established by the FHLBSF. As of December 31, 2008, no amounts were outstanding under these arrangements.

NOTE 8. 401(K) EMPLOYEE BENEFIT PLAN

All employees of the Bank, after completing 90 days of service, 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. Employees may contribute to the Plan up to certain limits prescribed by the Internal Revenue Service. To date, the Bank does not match employee contributions.

NOTE 9. STOCK OPTIONS

The Bank has adopted a qualified stock option plan (the Plan) for employees, non-employee directors and Bank founders, under which a maximum of 396,000 shares of Bank's common stock may be issued. The 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 following is a summary of the status relating to the Bank's stock option plan as of December 31, 2008 and changes during the year ended as presented below:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value
Options outstanding at beginning of year	262,897	$11.88		
Granted	29,500	$17.07		
Exercised	-	$0.00		
Forfeited or expired	(1,100)	$19.07		
Options outstanding at end of year	291,297	$12.38	5.90 years	$444,370
Options exercisable	252,592	$11.25	5.42 years	$444,303

The number and weighted average grant date fair value of options granted is as follows for the years ended December 31, 2008 and 2007:

	Number	Weighted Average Grant Date Fair Value
2008	29,500	$6.37
2007	16,250	$9.04

The aggregate intrinsic value of options exercised is as follows for the years ended December 31, 2008 and 2007:

2008	$ 0
2007	$ 176,534

The fair value of each option grant was estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions used for 2008 and 2007 as follows:

	2008	2007
Expected life (yrs.)	6.25	6.25
Volatility	29.70%	31.00%
Risk free rate of return	3.89%	4.43%
Dividend yield	0.00%	0.00%

NOTE 10. BANK OWNED LIFE INSURANCE

The Bank has purchased insurance on the lives of certain senior key employees. The policies accumulate asset values to meet future liabilities including the payment of employee benefits such as deferred compensation. Increases in the cash surrender value are recorded as other non-interest income in the Statement of Operations. The cash surrender value of bank owned life insurance is reflected as a separate line item in the Statement of Condition.

NOTE 11. RELATED PARTY TRANSACTIONS

In the ordinary course of business, the Bank makes loans to directors, officers, shareholders and their associates on substantially the same terms, including interest rates, origination and commitment fees, and collateral, as comparable transactions with unaffiliated persons, and such loans do not involve more than the normal risk of collectability. At December 31, 2008 and 2007, no related party loans were on non-accrual or classified for regulatory reporting purposes.

Total loans and extensions of credit made to or guaranteed by the Bank's directors and officers and their related companies totaled $784,000 and $824,000 at December 31, 2008 and December 31, 2007, respectively. Loan related activity to directors, officers and principal shareholders and their associates for the years ended December 31, 2008 and 2007 is as follows:

	2008	2007
Balance at beginning of year	$ 306,105	$ 140,017
New loans or disbursements	778,161	987,836
Principal repayments	821,589	821,748
Balance at end of year	$ 262,677	$ 306,105

NOTE 12. PENSION 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, 2008 and 2007.

	Year ended December 31, 2008	Restated 2007
Change in benefit obligation		
Benefit obligation at the beginning of the year	$ 960,144	$ 862,888
Service cost	177,204	88,269
Interest cost	65,966	54,750
Amendments	-	-
Actuarial (gains)/losses	(16,726)	(45,763)
Expected benefits paid	-	-
Projected benefit obligation at the end of the year	1,186,588	960,144
Funded status	(1,186,588)	(960,144)
Unrecognized net actuarial (gain) loss	(30,364)	(13,638)
Unrecognized prior service cost	63,850	72,330
Unrecognized net transition obligation (assets)	-	-
(Accrued)/ prepaid benefit cost	(1,153,102)	(901,452)
Accrued Benefit Liability	(1,186,588)	(960,144)
Accumulated Other Comprehensive Expense (Income)	33,486	58,692
Net Amount Recognized	$ (1,153,102)	$ (901,452)
Weighted average assumptions to determine benefit obligation as of December 31:		
Discount rate	5.90%	5.80%
Rate of compensation increase	N/A	N/A

The components of net periodic benefit cost recognized for the years ended December 31, 2008 and 2007 and the amounts in accumulated other comprehensive income expected to be recognized as components of net periodic benefit cost during the year ended December 31, 2009 are as follows:

	2009	2008	2007
Components of net periodic benefit cost			
Service cost	$ 138,386	$ 177,204	$ 88,269
Interest Cost	78,173	65,966	54,751
Expected return on plan assets	-	-	-
Amortization of transition obligation (asset)	-	-	-
Amortization of prior service cost	8,480	8,480	8,480
Amortization of actuarial (gains)/ losses	-	-	-
Net periodic benefit cost	$ 225,039	$ 251,650	$ 151,500

NOTE 13. RESTRICTIONS, COMMITMENTS, CONTINGENCIES 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. Effective December 16, 2008, Santa Cruz County Bank implemented the deposit reclassification program that simply changes the way the Bank reports deposit accounts to the Federal Reserve Bank. This change will decrease the amount of funds that we have to keep on deposit at the Federal

Reserve Bank, providing more funds for lending and investment purposes during 2009. At December 31, 2008, December 31, 2007 and December 31, 2006, the Bank's reserve requirement was $3,171,000, $1,400,000 and $876,000, respectively.

As compensation for check clearing and other services, compensating balances of approximately $10,000 were maintained with correspondent banks at December 31, 2008 and 2007. 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.

Building Lease Commitments: The Bank relocated its main office located in Santa Cruz at 325 Soquel Avenue to 720 Front Street. The Bank entered into a lease for the property located at 720 Front Street effective December 4, 2006 which commenced sixty days after the Landlord's Delivery of Possession on July 14, 2008. The lease expires July 14, 2018 with an option to extend for two additional 5 year periods. Base rent for the initial term of the lease is fixed at $16,791 monthly plus an allocation of 12.22% for triple net expenses and adjusts annually on the lease anniversary date equal to the annual percentage increase that occurs in the Consumer Price Index, but no less than 3% and not more than 6%.

The lease for the Bank's Scotts Valley Office at 4604 Scotts Valley Drive commenced on October 1, 2004, and expires on June 30, 2011, with an option to extend for two additional 5 year periods. The monthly lease payment for the Scotts Valley Office increased to $3,000 commencing June 1, 2008 due to additional office space acquired. Monthly rent will continue at this amount through the sixtieth month, after which it is subject to annual CPI increases. The first fifteen months of the Scotts Valley Office lease were rent free. The straight-line rent expense for the sixty month period is approximately $2,100 per month. Triple net expenses of 24% will be incurred in addition to these lease payments.

The lease for the Watsonville Office at 595 Auto Center Drive commenced on December 1, 2004, and expires January 24, 2015, with an option to extend for an additional 5 year period. Base rent for the initial term of the Watsonville lease is fixed at $4,013 monthly plus an allocation of 12.00% for triple net expenses, which is adjusted annually for actual expenses incurred by landlord.

The lease for the Bank's Business Lending Office at 1500 41st Avenue, Suite 100 commenced on November 1, 2006, and expires October 31, 2011, with an option to extend for three additional 5 year periods. Base rent for the initial term is fixed at $3,074 monthly plus triple net expenses, and adjusts on each anniversary date equal to the annual percentage increase that occurs in the Consumer Price Index, but no less than 3% and not more than 5%. The Bank received a rent credit of $32,296, which is applied toward the base rent each month for approximately the first ten months of the lease. The straight-line rent expense for the first year is approximately $2,500 per month.

The lease for the Bank's Capitola Office at 819 Bay Avenue, Suite D commenced on February 7, 2007, and expires February 6, 2017, with an option to extend for an additional 5 year period. Base rent for the initial term is fixed at $5,076 monthly plus triple net expenses. The monthly base rent shall increase to $5,686 monthly beginning with the first day of March, 2012 for the remaining lease term.

The lease for the Bank's Aptos Office at 7775 Soquel Drive commenced December 15, 2008. The lease expires November 30, 2013 with an option to extend for three additional 5 year periods. Base rent for the initial term of the lease is fixed at $6,262 monthly. Operating expenses will not exceed $0.55 per square foot for the first year and will be increased no more than 3% on an annual basis.

The lease for the Bank's Administrative Office at 740 Front Street commenced August 1, 2008. The lease expires July 31, 2013 with an option to extend for an additional 5 year period. Base rent through December 31, 2008 is fixed at $1,984 monthly plus an allocation of 8.93% for triple net expenses. Monthly rent will increase over the five year lease period to full market value of $8,672 per month by January 1, 2013.

In addition to the office building leases, the Bank has two leases for ATM & night depository kiosks. The operating lease for the kiosk at 1555 Soquel Drive, Santa Cruz, California, expires in November, 2010, with an option to extend for one additional period of three years. The monthly lease payment for the Santa Cruz kiosk was originally $500 and is subject to annual CPI increases during the initial term. Base rent at December 31, 2008 was $555. The operating lease for the kiosk at 783-25 Rio Del Mar Boulevard, Aptos, California, expires in November, 2010, with an option to extend for six additional periods of three years each. The quarterly lease payment for the Aptos kiosk is $216.

Minimum lease payments for future years under the six building leases and two kiosk leases are as follows:

Year ending December 31,	
2009	531,611
2010	575,316
2011	553,102
2012	512,702
Thereafter	1,751,736
	$ 3,924,467

Building and kiosk rent expense for the year ended December 31, 2008 and December 31, 2007, was $372,694 and $264,288 respectively.

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 and financial guarantees. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated 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 to the financial instrument for commitments to extend credit and standby letters of credit and financial guarantees written 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, 2008 and December 31, 2007 are as follows:

	December 31, 2008	December 31, 2007
Commitments to extend credit	$ 44,728,804	$ 53,664,833
Standby letters of credit	2,357,034	2,954,166
	$ 47,085,838	$ 56,618,999

Legal Matters: The Bank is subject to certain legal proceedings arising in the normal course of business. At December 31, 2008, the Bank was not subject to any claims and/or lawsuits.

NOTE 14. OTHER OPERATING INCOME AND EXPENSE

The following is a breakdown of other non-interest income and non-interest expense in the Statement of Operations as of December 31:

	December 31, 2008	December 31, 2007
Other non-interest income:		
BOLI non-interest income	$ 135,905	$ 128,682
Gain on sale of loans	398,479	349,341
Other non-interest income	515,028	373,033
Total other non-interest income	$ 1,049,412	$ 851,056
Other non-interest expense:		
Stationery, supplies and printing	$ 84,210	$ 83,696
Armored car and messenger	95,613	76,877
Telephone, postage and electronic communications	86,296	68,068
Correspondent bank charges	139,852	112,504
Insurance and security	52,349	48,408
Loan and collection expense	137,083	57,970
ATM related expenses	105,403	84,219
Shareholder related expense	127,103	45,419
Regulatory assessments	155,110	125,948
Other non-interest expenses	467,085	191,273
Total other operating expenses	$ 1,450,104	$ 894,382

NOTE 15. CAPITAL ADEQUACY

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 undercapitalized, and critically undercapitalized. 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, 2008, 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 and not be subject to a capital directive order (such as a Formal Agreement). There are no conditions or events since that notification that Management believes has changed the Bank's risk-based capital category.

(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, 2008						
Total capital (to risk weighted assets)	$ 20,252	11.65%	$ 13,913	8.00%	$ 17,391	10.00%
Tier 1 capital (to risk weighted assets)	$ 18,070	10.39%	$ 6,956	4.00%	$ 10,434	6.00%
Tier 1 capital (to average assets) leverage ratio	$ 18,070	8.15%	$ 8,874	4.00%	$ 11,092	5.00%
As of December 31, 2007						
Total capital (to risk weighted assets)	$ 20,367	13.94%	$ 11,692	8.00%	$ 14,615	10.00%
Tier 1 capital (to risk weighted assets)	$ 18,579	12.71%	$ 5,846	4.00%	$ 8,769	6.00%
Tier 1 capital (to average assets) leverage ratio	$ 18,579	12.09%	$ 6,148	4.00%	$ 7,685	5.00%

The leverage ratio consists of Tier 1 capital divided by quarterly average assets, excluding intangible assets and certain other items. The minimum leverage ratio guideline is 4% for banking organizations that do not anticipate significant growth and that have well-diversified risk, excellent asset quality, high liquidity, good earnings and, in general, are considered top-rated, strong banking organizations.

NOTE 16. FAIR VALUE OF FINANCIAL INSTRUMENTS

In accordance with SFAS No. 157, the Bank groups its financial assets and financial 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. These levels are:

Level 1 – Valuations for assets and liabilities traded in active exchange markets, such as the New York Stock Exchange. Level 1 also includes U.S. Treasury, other U.S. government and agency mortgage-backed securities that are traded by dealers or brokers in active markets. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2 – Valuations for assets and liabilities traded in less active dealer or broker markets. Valuations are obtained from third party pricing services for identical or comparable assets or liabilities.

Level 3 – Valuations for assets and liabilities that are derived from other valuation methodologies, including option pricing models, discounted cash flow models and similar techniques, and not based on market exchange, dealer, or broker traded transactions. Level 3 valuations incorporate certain assumptions and projections in determining the fair value assigned to such assets or liabilities.

The only assets measured at fair value on a recurring basis are the Available for Sale Securities which total $30,745,169 at December 31, 2008, and are determined under the Level 2 assumption.

The following table presents the carrying amounts and estimated fair values of the Bank's financial instruments at December 31, 2008 and December 31, 2007. 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 Federal Home Loan Bank stock, 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,			
	2008		2007	
	Amount	Value	Amount	Value
Financial Assets:				
Cash and cash equivalents	$ 13,994,538	$ 13,994,538	$ 12,708,754	$ 12,708,754
Certificates of deposit	30,877,500	30,877,500	1,000,000	1,000,000
Securities available-for-sale	30,745,169	30,745,169	19,900,590	19,900,590
Securities held-to-maturity	846,963	857,281	1,048,149	1,027,970
Loans, net	143,199,375	141,742,162	117,169,433	116,934,223
Accrued interest receivable	764,060	764,060	672,218	672,218
Bank owned life insurance	3,596,558	3,596,558	3,460,653	3,460,653
Financial Liabilities:				
Noninterest-bearing demand deposits	$ 63,386,131	$ 63,386,131	$ 44,200,647	$ 44,200,647
Interest-bearing demand deposits	12,927,077	12,927,077	8,598,091	8,598,091
Savings and money market deposits	68,630,762	68,630,762	53,739,693	53,739,693
Time certificates of deposit	62,252,416	62,011,016	32,470,437	32,478,896
Accrued interest payable	362,929	362,929	512,511	512,511
Other liabilities	2,552,796	2,552,796	1,560,618	1,560,618

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

Cash and cash equivalents: Carrying amount is a reasonable estimate of fair value.

Securities: The fair values of securities classified as available for sale and held to maturity are based on quoted market prices at the reporting date for those or similar investments.

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. Variable rate loans which re-price frequently with changes in approximate market rates were valued using the outstanding principal balance. The estimated fair value of loan commitments and contingent liabilities at December 31, 2008 and December 31, 2007 approximate their current book values.

Accrued Interest Receivable: Carrying amount is a reasonable estimate of fair value.

Bank Owned Life Insurance: Carrying amount is a reasonable estimate of fair value.

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

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.

Accrued Interest Payable: Carrying amount is a reasonable estimate of fair value.

Other Liabilities: Carrying amount is a reasonable estimate of fair value.

OUR BOARD OF DIRECTORS

AS PICTURED LEFT TO RIGHT:

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Hansen Insurance Company

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President
The ATG Group

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

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

Steven G. John
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Ocean Honda

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Director of Client Relations
Scharf Investments

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President & CEO
Santa Cruz County Bank

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Susan Chandler, Senior Vice President, SBA Department Manager
Angelo DeBernardo, Jr., Senior Vice President, Senior Lending Officer
Jim Earnhardt, Senior Vice President, IT, Operations & Facilities
Janice Zappa, Vice President, Corporate Secretary

SHAREHOLDER INFORMATION

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 Street, Suite 800
Golden, CO 80401
Phone: 800.962.4284
Internet: www.computershare.com

Santa Cruz County Bank's common stock is listed on the Over the Counter Bulletin Board under the ticker symbol SCZC.

BANKING OFFICE, ATMS, & OTHER LOCATIONS

BANKING LOCATIONS

APTOS
7775 Soquel Dr.
Aptos, CA 95003
831.662.6000

CAPITOLA
819 Bay Ave, Ste D
Capitola, CA 95010
831.464.5300

SANTA CRUZ
720 Front St.
Santa Cruz, CA 95060
831.457.5000

SCOTTS VALLEY
4604 Scotts Valley Dr.
Scotts Valley, CA 95066
831.461.5000

WATSONVILLE
595 Auto Center Dr.
Watsonville, CA 95076
831.761.7600

BUSINESS LENDING OFFICE

CAPITOLA
1500 41st Ave, Ste 100
Capitola, CA 95010
831.462.8800

ATM & NIGHT DEPOSITORY LOCATIONS

SANTA CRUZ
1555 Soquel Dr.
Santa Cruz CA 95065
(At Dominican Hospital)

APTOS
783-25 Rio Del Mar Blvd.
Aptos, CA 95003
(At Deluxe Foods)

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