2010 Annual Report

SANTA CRUZ COUNTY BANK

Celebrating 7 years of serving Santa Cruz County

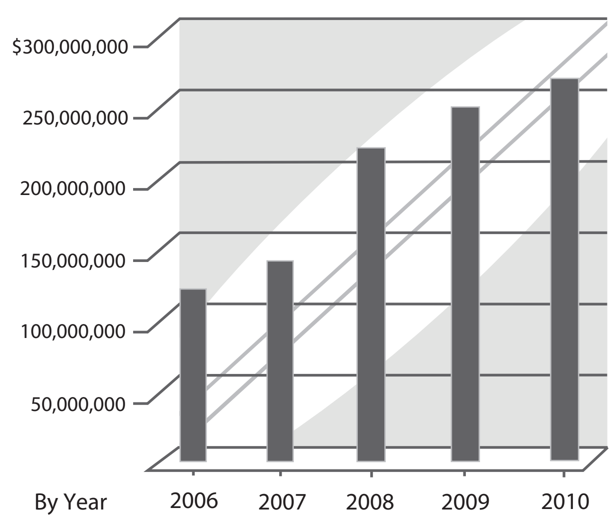
Put your money where your life is.

LOCAL BANKING AT ITS BEST

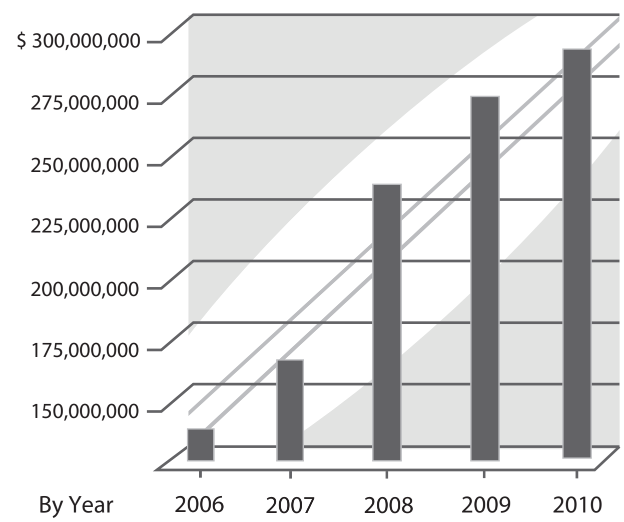
Founded by a group of local business people who share a common commitment to the Santa Cruz area, Santa Cruz County Bank first opened its doors on February 3, 2004. Santa Cruz County Bank is a locally owned and operated commercial bank, serving the needs of the residents and businesses of Santa Cruz County. We believe strongly in the importance of local decision making and responsive customer service. We offer a complete line of loan and depository products. 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. Every Santa Cruz County Bank location is Green Business Certified.

YEARLY GROWTH 2006 - 2010

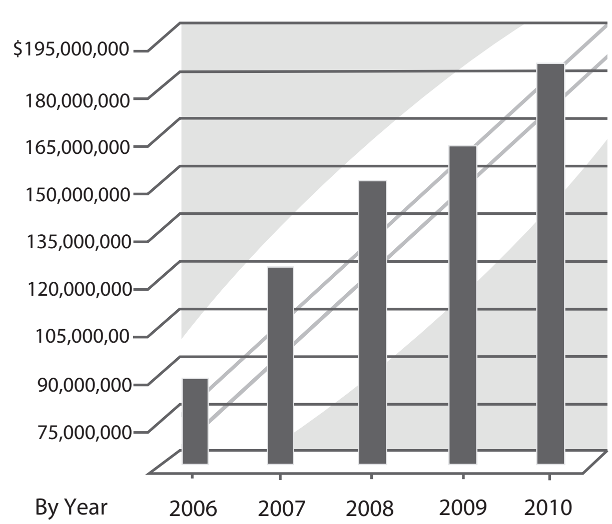
Total Deposits



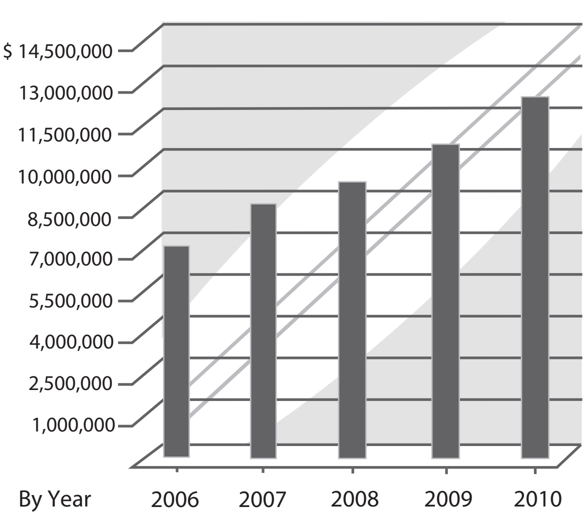
Total Assets



Gross Loans



Net Interest Income



To Our Shareholders,

We are pleased to present our Annual Report and highlights for 2010.

As we enter into our 8th year of operations, we wish to thank all of our shareholders, customers, community supporters and employees for making it a gratifying year. Our ongoing commitment to controlling expenses and other strategic planning initiatives resulted in notable profitability in 2010. Net Income of $1.8 million placed us 6th in ranking for net income in our California peer bank group* of 53 banks and placed us 9th in return on average assets. Our performance and delivery of excellent customer service continues to set us apart from other financial institutions and serves as a catalyst for attracting new customers.

Our focus in 2010 on loan production, a bank's best yielding asset, resulted in a year over year increase in gross loans of 16% or $25 million for a record total of $181.5 million. We broadened our array of loan products to include Farm Service Agency (FSA) loans through the USDA. The addition of FSA lending complements our already robust Business & Industry (B&I) lending through the USDA, our Preferred Lender status through the Small Business Administration (SBA), and is a fit with the agricultural related industries within and contiguous to our market area.

2010 Highlights

Santa Cruz County Bank was designated as a Super Premier Performing Bank in 2010 by the Findley Reports, Inc., a highly regarded financial industry consulting firm.

The Bank achieved "Excellent" 4-Star Bauer Financial Ratings for each quarter in 2010. The Bank has received the 4-Star rating by Bauer for ten consecutive quarters.

The Bank raised $2.5 million in capital through a Private Stock Offering.

Total assets surpassed $280 million, a historic milestone.

As of June 30, 2010, the Bank's market share of deposits held by FDIC insured institutions in the County of Santa Cruz increased to 6.07% from 5.18% the prior year.

Also as of June 30, 2010, Santa Cruz County Bank made the top 25 depository list of Silicon Valley's biggest banks for the first time. The Bank ranked 25th overall for the Silicon Valley region which includes Santa Clara, Santa Cruz, Monterey and San Benito Counties as well as Fremont, Newark, Union City and much of San Mateo County.

**California peer group consists of 53 insured commercial banks in California with assets between $100 million and $300 million, with 3 or more full service banking offices and located in a metropolitan statistical area.*

Santa Cruz County Bank was recognized in 2010 by USDA Rural Development for Lender Excellence in 2009 as follows:

- Santa Cruz County Bank ranked 3rd in California and 13th in the Nation for its Business & Industry (B&I) lending volume.

- Susan Chandler, who heads the Bank's SBA Department, received the Exceptional Leadership Award for 2009.

- Daljit Bains, Vice President & SBA Loan Officer, received the Outstanding Loan Officer Award for the USDA's Business & Industry Loan Program.

Santa Cruz County Bank ranked 10th in total SBA 7(a) and 504 loans approved in Silicon Valley for the 2010 fiscal year. Silicon Valley includes Alameda, San Mateo, Santa Clara and Santa Cruz counties.

Santa Cruz County Bank achieved Gold Certification, which is the second highest level of certification for Leadership in Energy and Environmental Design (LEED) for the remodeling of its Santa Cruz Office at 720 Front Street.

Throughout the year, Santa Cruz County Bank's Board, Management and employees were continually involved in community events. Santa Cruz County Bank received the Second Harvest Food Bank's Gold Can award for the Holiday Food Drive; received a Bronze Award from United Way for our Annual pledge campaign and participated in Bowl for Kids Sake, the Human Race Walkathon, and the Relay for Life.

David V. Heald, President and CEO and George Gallucci, Chairman

As we progress into 2011, it is our goal to continue to execute the initiatives that gave us favorable results in 2010 and to continue our mission to be the local bank of choice in Santa Cruz County.

We value your continued support and confidence in Santa Cruz County Bank.

George Gallucci
Chairman of the Board

David Heald
President & CEO

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THE POWER OF CONFIDENCE

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INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying balance sheet of Santa Cruz County Bank as of December 31, 2010 and 2009, and the related statements of operations, changes in shareholders' 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 audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Santa Cruz County Bank as of December 31, 2010 and 2009, 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.

Perry-Smith LLP

March 15, 2011

STATEMENT OF CONDITION
December 31, 2010 and 2009

	December 31, 2010	December 31, 2009
ASSETS		
Cash and due from banks	$ 6,215,909	$ 7,618,009
Federal funds sold	7,092,818	88,567
Interest bearing deposits in other financial institutions	1,177	48,214
Total cash and cash equivalents	13,309,904	7,754,790
Certificates of deposit in other financial institutions	54,069,000	58,248,000
Securities available for sale, at fair value	25,791,005	32,386,826
Securities held to maturity, at amortized cost	451,765	640,692
Total investment securities	26,242,770	33,027,518
Loans receivable (net of allowance for loan losses of $3,558,521 at December 31, 2010 and $2,898,478 at December 31, 2009)	177,831,604	153,501,464
Bankers' Bank stock, at cost	1,026,200	935,400
Premises and equipment, net	1,664,861	2,052,134
Accrued interest receivable	830,540	815,087
Bank owned life insurance	4,868,404	3,730,691
Deferred income tax	2,011,156	1,236,000
Other real estate owned	1,358,403	1,294,789
Other assets	1,693,361	2,509,320
TOTAL ASSETS	$ 284,906,203	$ 265,105,193
LIABILITIES AND SHAREHOLDERS' EQUITY		
LIABILITIES		
Non-interest bearing deposits	$ 94,326,653	$ 75,895,196
Interest bearing deposits	159,089,391	163,408,441
Total deposits	253,416,044	239,303,637
Accrued interest payable	182,952	303,027
Borrowings	3,787,375	3,000,000
Other liabilities	3,949,480	2,905,551
Total liabilities	261,335,851	245,512,215
Commitments and contingencies (Note 13)		
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; 1,908,940 shares issued and outstanding at December 31, 2010; 1,667,340 shares issued and outstanding at December 31, 2009	21,103,659	18,624,863
Additional paid-in-capital	620,655	581,516
Retained earnings	2,137,215	314,520
Accumulated other comprehensive (loss) income, net of taxes	(291,177)	72,079
Total shareholders' equity	23,570,352	19,592,978
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 284,906,203	$ 265,105,193

See Notes to Financial Statements

STATEMENT OF OPERATIONS
For the years ended December 31, 2010 and 2009

	2010	2009
INTEREST AND DIVIDEND INCOME:		
Federal funds sold	$ 11,540	$ 19,369
Interest bearing deposits in other financial institutions	1,319,367	1,250,636
Investment securities	1,034,896	1,261,917
Loans receivable, including fees	10,287,399	9,080,541
Total interest and dividend income	12,653,202	11,612,463
INTEREST EXPENSE:		
Deposits	967,804	1,591,035
Borrowings	1,078	380
Total interest expense	968,882	1,591,415
Net interest income before provision for loan losses	11,684,320	10,021,048
Provision for loan losses	1,200,000	1,250,196
Net interest income after provision for loan losses	10,484,320	8,770,852
NON-INTEREST INCOME:		
Service charges and fees on deposit accounts	700,165	632,958
Gain on sale of loans	560,719	511,820
Gain on sale of securities	596,923	110,697
Other income	906,882	723,636
Total non-interest income	2,764,689	1,979,111
NON-INTEREST EXPENSE:		
Compensation and employee benefits	5,610,231	5,958,437
Occupancy	1,062,574	1,061,162
Furniture and equipment	405,324	504,404
Marketing and business development	235,696	344,906
Data and item processing	424,315	389,259
Professional services	356,886	288,846
Regulatory assessments	616,620	532,756
(Reduction of) provision for off balance sheet commitments	(4,453)	18,381
Other expenses	1,545,495	1,290,154
Total non-interest expense	10,252,688	10,388,305
Net income before provision for income taxes	2,996,321	361,658
Provision for income taxes	1,173,626	158,787
Net income	$ 1,822,695	$ 202,871
BASIC EARNINGS PER SHARE	$ 1.08	$ 0.12
DILUTED EARNINGS PER SHARE	$ 1.08	$ 0.12
Basic weighted average shares outstanding	1,695,141	1,666,778
Diluted weighted average shares outstanding	1,695,141	1,666,778

See Notes to Financial Statements

STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
AND COMPREHENSIVE INCOME
For the years ended December 31, 2010 and 2009

	Common Stock		Additional Paid In	Retained	Accumulated Other Comprehensive	Total Shareholders'	Total Comprehensive
	Shares	Amount	Capital	Earnings	(Loss) Income	Equity	(Loss) Income
Balance at December 31, 2008	1,662,340	$ 18,574,863	$ 446,074	$ 111,649	$ (144,612)	$ 18,987,974	$ (166,397)
Exercise of stock options	5,000	50,000	-			50,000	
Share-based compensation			135,442			135,442	
Net income				202,871		202,871	202,871
Amortization of pension cost					(12,161)	(12,161)	(12,161)
Change in unrealized gain on securities available for sale, net of tax of $197,907					228,852	228,852	228,852
Balance at December 31, 2009	1,667,340	$ 18,624,863	$ 581,516	$ 314,520	$ 72,079	$ 19,592,978	$ 419,562
Proceeds from stock offering, net of offering expenses of $21,764	241,600	2,478,796				2,478,796	
Share-based compensation			39,139			39,139	
Net income				1,822,695		1,822,695	1,822,695
Amortization of pension cost, net of tax of $53,801					(77,929)	(77,929)	(77,929)
Net change in unrealized gain on securities available for sale, net of tax of $198,732					(285,327)	(285,327)	(285,327)
Balance at December 31, 2010	1,908,940	$ 21,103,659	$ 620,655	$ 2,137,215	$ (291,177)	$ 23,570,352	$ 1,459,439

See Notes to Financial Statements

STATEMENT OF CASH FLOWS
For the years ended December 31, 2010 and 2009

	December 31, 2010	December 31, 2009
OPERATING ACTIVITIES:		
Net income	$ 1,822,695	$ 202,871
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for deferred income tax	(523,103)	158,787
Depreciation and amortization of premises and equipment	501,829	543,942
Accretion of discounts, net of amortization for investments	374,585	199,400
Net loan amortization and accretion	9,483	(61,853)
Provision for loan losses	1,200,000	1,250,196
(Reduction of) provision for unfunded loan commitments	(4,453)	18,381
Increase in cash value of bank owned life insurance	(137,713)	(134,133)
Gain on sale of available-for-sale securities	(596,923)	(110,697)
Gain on sale of SBA loans	(560,719)	(511,820)
Loss on sale of OREO or write-downs	148,254	-
(Gain) loss on sale/disposal of assets	(367)	461
Share-based compensation	39,139	135,442
Deferred benefit expense	333,236	234,156
Increase in accrued interest receivable	(15,453)	(51,027)
(Increase) decrease in deferred loan fees, net of costs	(65,128)	103,633
Decrease (Increase) in other assets	815,959	(1,826,411)
Decrease in accrued interest payable	(120,075)	(59,902)
Increase in other liabilities	582,731	88,058
Net cash provided by operating activities	3,803,977	179,484
INVESTING ACTIVITIES:		
Principal repayments on securities held to maturity	188,032	204,832
Proceeds from the sale of securities available for sale	11,735,261	2,685,051
Proceeds from matured and called securities available for sale	2,000,000	7,460,714
Principal repayments on securities available for sale	5,507,434	6,990,558
Purchases of securities available for sale	(12,906,535)	(18,438,485)
Redemption of certificates of deposit in other financial institutions	43,449,000	-
Purchase of certificates of deposit in other financial institutions	(39,270,000)	(27,370,500)
Purchases of Federal Home Loan Bank stock	(90,800)	(161,000)
Purchase of bank owned life insurance	(1,000,000)	-
Net proceeds from sales of loans	7,911,769	8,650,058
Net increase in loans	(29,250,038)	(21,027,092)
Purchases of premises and equipment	(114,589)	(571,619)
Proceeds from sale of assets	400	1,000
Net cash used by investing activities	(11,840,066)	(41,576,483)
FINANCING ACTIVITIES:		
Net proceeds from exercise of stock options	-	50,000
Proceeds from stock offering, net of expenses	2,478,796	-
Proceeds from borrowings	26,435,000	3,000,000
Repayments of borrowings	(29,435,000)	
Net Increase in deposits	14,112,407	32,107,251
Net cash provided by financing activities	13,591,203	35,157,251
Net increase (decrease) in cash and cash equivalents	5,555,114	(6,239,748)
Cash and cash equivalents at beginning of period	7,754,790	13,994,538
Cash and cash equivalents at end of period	$ 13,309,904	$ 7,754,790
Cash paid during the year:		
Interest paid	$ 1,088,957	$ 1,651,761
Income taxes paid	1,635,834	43,000
Supplemental disclosures of non-cash investing activities:		
Transfer of loans to other real estate owned	211,868	1,294,789
Net change in unrealized gain on securities available for sale	482,894	426,759

See Notes to 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 participates in the FDIC Transaction Account Guarantee Program. All non-interest bearing transaction accounts are fully guaranteed by the FDIC for the entire amount in the account through December 31, 2010. Coverage under the Program is in addition to and separate from the coverage available under the FDIC's general deposit insurance rules. The FDIC approved a final rule on November 9, 2010 to implement section 343 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Section 343 provides temporary unlimited coverage for noninterest-bearing transaction accounts. This separate coverage will become effective on December 31, 2010, and will end on December 31, 2012.

The majority of the Bank's business is conducted with customers located in Santa Cruz and adjacent counties. Generally, the Bank maintains loan-to-value ratios no greater than 75 percent on commercial, multi-family and single-family residential real estate loans, with the exception of government guaranteed real estate loans which may be maintained at larger loan-to-value ratios. At December 31, 2010, the Bank had loans outstanding of approximately $137,703,000 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 accounting principles generally accepted in the United States of America ("GAAP") and prevailing practices within the banking industry.

Use of Estimates: The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. 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, municipal bonds and corporate trust preferred securities. 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 of premiums or accretion of 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 entitled "accumulated other comprehensive income" until realized. During the years ended December 31, 2010 and December 31, 2009, 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.

An investment security is impaired when its carrying value is greater than its fair value. Investment securities that are impaired are evaluated on at least a quarterly basis and more frequently when economic or market conditions warrant such an evaluation to determine whether such a decline in their fair value is other than temporary. Management utilizes criteria such as 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. Once a decline in value is determined to be other than temporary, and management does not intend to sell the security or it is more likely than not that the Bank will not be required to sell the security before recovery, only the portion of the impairment loss representing credit exposure is recognized as a charge to earnings, with the balance recognized as a charge to other comprehensive income. If management intends to sell the security or it is more likely than not that the Bank will be required to sell the security before recovering its forecasted cost, the entire impairment loss is recognized as a charge to earnings.

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. The recorded investment of $856,200 and $765,400 as of December 31, 2010 and 2009, respectively, in FHLB stock is carried at cost. The FHLB stock is redeemable at its par value of $100 per share at the discretion of the FHLB of San Francisco. No ready market exists for FHLB stock, and it has no quoted market value. The FHLB can suspend dividends and redemptions upon notification to its members.

Loans: Loans are stated at the amount of unpaid principal balances outstanding, net deferred loan origination fees, and reduced by the allowance for loan losses. Interest is accrued daily and credited to income as it is earned based on outstanding loan balance. 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. 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.

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 or when the loan becomes well-secured and in the process of collection.

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, 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, or classified in part or in whole as either doubtful or loss. 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 accounts for loans held for sale in accordance with FASB ACS Topic 860, *Transfers and Servicing*. The statement provides accounting and reporting standards for transfers 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.

Real Estate Acquired through Foreclosure: Real estate properties acquired through foreclosure are to be sold and are initially recorded at fair value of the property, less estimated selling expenses. Any write-down to fair value at the time of transfer to foreclosed real estate is charged to the allowance for loan losses. Properties are evaluated regularly to ensure that the recorded amounts are supported by their current fair values. Any subsequent reductions in carrying values and revenue and expenses from the operations of properties are charged to operations. Operating expenses incurred in conjunction with the maintenance of real estate acquired through foreclosure are charged to operations as incurred. The Bank had $1,358,403 and $1,294,789 in foreclosed real estate at December 31, 2010 and December 31, 2009, respectively.

Allowance for Loan Losses: The allowance for loan losses is an estimate of credit losses inherent 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. Credit exposures determined to be uncollectible are charged against the allowance. Cash received on previously charged off amounts is recorded as a recovery to the allowance. The overall allowance consists of two primary components, specific reserves related to impaired loans and general reserves for inherent losses related to loans that are not impaired.

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, including principal and interest, according to the contractual terms of the original agreement. Loans determined to be impaired are individually evaluated for impairment. When a loan is impaired, the Bank measures impairment based on 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.

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 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). 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, which is included on the consolidated balance sheet.

The Bank assigns a risk rating to all loans except pools of homogeneous 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 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 or an overbuilt market impact Agricultural real estate projects and may result in troubled loans. Trends in vacancy rates of Agricultural 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. 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. 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. 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.

Individual loans and receivables in homogeneous loan portfolio segments are not evaluated for specific impairment. Rather, the sole component of the allowance for these loan types is determined by collectively measuring impairment reserve factors based on management's assessment of the following for each homogeneous loan portfolio segment: (1) inherent credit risk, (2) historical losses and (3) other qualitative factors. These reserve factors are described in further detail below for each homogeneous loan portfolio segment.

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 Financial Institutions, 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.

Allowance for Credit Losses on Off-Balance-Sheet Credit Exposures: The Bank also maintains a separate allowance for off-balance-sheet commitments. Management estimates anticipated losses using historical data and utilization assumptions. The allowance for off-balance-sheet commitments is included in accrued interest payable and other liabilities on the consolidated balance sheet.

Servicing Rights: 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 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 lease term. Amounts accrued in excess of amounts paid related to the unamortized deferred credits are included in other liabilities on the balance sheet.

When assets are sold or otherwise disposed of, the cost and related accumulated depreciation or amortization are removed from the accounts, and any resulting gain or loss is recognized in income for the period. The cost of maintenance and repairs is charged to expense as incurred. The Bank evaluates premises and equipment for financial impairment as events or changes in circumstances indicate that the carrying amount of such assets may not be fully recoverable.

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. 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 has accounted for uncertainty in income taxes as required by the *Accounting for Uncertainty in Income Taxes* topic of the FASB Accounting Standards Codification. 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.

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. The Bank does not have any uncertain income tax positions and has not accrued for any interest or penalties as of December 31, 2010 and 2009.

Stock-Based Compensation: The Bank has one share-based compensation plan, the 2003 Stock Option Plan (the "Plan"), which has been approved by its shareholders and permits the grant of stock options for up to 500,202 shares of the Bank's common stock. The Plan is designed to attract and retain employees and directors. The amount, frequency, and terms of share-based awards may vary based on competitive practices, the Bank's operating results and government regulations. New shares are issued upon option exercise. The Plan requires that the exercise price may not be less than the fair market value of the stock at the date the option is granted.

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 since dividends have not been paid and there are no current plans to do so in the foreseeable future.

No stock-based compensation costs were capitalized as part of the cost of an asset as of December 31, 2010. As of December 31, 2010, $87,000 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: Accounting Standards Codification Topic 260, 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 or when stock options are not in-the-money. The following table summarizes the weighted average shares outstanding used to compute earnings per share:

	Year ended December 31, 2010	2009
Net Income, as reported	$ 1,822,695	$ 202,871
Earnings per share, basic	$ 1.08	$ 0.12
Earnings per share, diluted	$ 1.08	$ 0.12
Weighted average shares outstanding, basic	1,695,141	1,666,778
Weighted average shares outstanding, diluted	1,695,141	1,666,778

There were 281,090 options to acquire common stock that could potentially dilute basic earnings per share in the future that were not included in the computation of diluted earnings per share because to do so would have been anti-dilutive for year ended December 31, 2010.

Comprehensive Income (loss): Comprehensive income (loss) is reported in addition to net income for all periods presented. Comprehensive income (loss) is a more inclusive financial reporting methodology that includes disclosure of other comprehensive income (loss) that historically has not been recognized in the calculation of net income. Other comprehensive earnings include the adjustment to fully recognize the liability associated with the supplemental executive retirement plan as required by the FASB Accounting Standards Codification ASC Topic 715 relating to Compensation-Retirement Benefits and unrealized gains and losses on the Bank's available-for-sale investment securities, adjusted for realized gains or losses included in net income (loss). Total comprehensive income (loss) and the components of accumulated other comprehensive income (loss) are presented in the statement of changes in shareholders' equity and comprehensive income (loss).

Disclosure About 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.

Adoption of New Financial Accounting Standards

Transfers of Financial Assets
In June 2009, the Financial Accounting Standards Board ("FASB") issued FASB Accounting Standards Update ("ASU") 2009-16*, Accounting for Transfers of Financial Assets (Statement 166)*, which amends previously issued accounting guidance to enhance accounting and reporting for transfers of financial assets, including securitizations or continuing exposure to the risks related to transferred financial assets. Prior to the issuance of Statement 166, transfers under participation agreements and other partial loan sales fell under the general guidance for transfers of financial assets. Statement 166 introduces a new definition for a participating interest along with the requirement for partial loan sales to meet the definition of a participating interest for sale treatment to occur. If a participation or other partial loan sale does not meet the definition, the portion sold should remain on the books and the proceeds recorded as a secured borrowing until the definition is met. Additionally, existing provisions that require the transferred assets to be isolated from the originating institution (transferor), that the transferor does not maintain effective control through certain agreements to repurchase or redeem the transferred assets and that the purchasing institution (transferee) has the right to pledge or exchange the assets acquired were retained. The new provisions became effective on January 1, 2010 and early adoption was not permitted. Under this new standard, the Bank's loan participations were not affected, but the Bank deferred approximately $259,000 of gains and recorded $3,787,375 of secured borrowings related to the sale of a portion of certain loans as of December 31, 2010. These gains will be recognized when the warranty periods that precluded the sales from meeting the participating interest standard expires.

Fair Value Measurements
In January 2010, the FASB issued FASB ASU 2010-06*, Improving Disclosures about Fair Value Measurements,* which amends and clarifies existing standards to require additional disclosures regarding fair value measurements. Specifically, the standard requires disclosure of the amounts of significant transfers between Level 1 and Level 2 of the fair value hierarchy and the reasons for these transfers, the reasons for any transfers in or out of Level 3, and information in the reconciliation of recurring Level 3 measurements about purchases, sales, issuances and settlements on a gross basis. This standard clarifies that reporting entities are required to provide fair value measurement disclosures for each class of assets and liabilities—previously separate fair value disclosures were required for each major category of assets and liabilities. This standard also clarifies the requirement to disclose information about both the valuation techniques and inputs used in estimating Level 2 and Level 3 fair value measurements. Except for the requirement to disclose information about purchases, sales, issuances, and settlements in the reconciliation of recurring Level 3 measurements on a gross basis, these disclosures are effective for the year ended December 31, 2010. The requirement to separately disclose purchases, sales, issuances, and settlements of recurring Level 3 measurements becomes effective for the Bank for the year beginning on January 1, 2011. The Bank adopted this new accounting standard as of January 1, 2010 and the impact of adoption was not material to the financial statements.

Disclosures about Credit Quality
In July 2010, the FASB issued FASB ASU 2010-20, *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*. ASU 2010-20 requires more robust and disaggregated disclosures about the credit quality of financing receivables (loans) and allowances for loan losses, including disclosure about credit quality indicators, past due information and modifications of finance receivables. The disclosures as of the end of a reporting period are effective for interim and annual reporting periods ending on and after December 15, 2010. The disclosures about activity that occurs during a reporting period are effective for interim and annual reporting periods beginning on or after December 15, 2010. The adoption of this guidance has significantly expanded disclosure requirements related to accounting policies and disclosures related to the allowance for loan losses but did not have an impact on the Bank's financial position, results of operation or cash flows.

Subsequent Events
The Bank has reviewed all events occurring from December 31, 2010 through March 15, 2011, the date the financial statements were issued and no subsequent events occurred requiring accrual or disclosure.

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.

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, 2010, and December 31, 2009. "U.S. Agency" refers to mortgage-backed securities issued by the Government National Mortgage Association ("GNMA"), 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 and collateralized mortgage-backed are labeled as "MBS."

December 31, 2010	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Securities available for sale:				
U.S. Agency Securities	$ 4,000,000	$ -	$ (66,340)	$ 3,933,660
U.S. Agency MBS's	16,067,875	581,639	(59,991)	16,589,523
Municipal	4,613,094	79,981	(122,963)	4,570,112
Corporate	838,511	-	(140,801)	697,710
Total securities available for sale	$ 25,519,480	$ 661,620	$ (390,095)	$ 25,791,005
Securities held to maturity:				
U.S. Agency MBS's	451,765	18,900	-	470,665
Total securities held to maturity	$ 451,765	$ 18,900	$ -	$ 470,665

December 31, 2009	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Securities available for sale:				
U.S. Agency Securities	$ 2,000,697	$ 17,883	$ -	$ 2,018,580
U.S. Agency MBS's	23,691,929	752,772	(21,222)	24,423,479
Municipal	5,108,311	192,991	(41,055)	5,260,247
Corporate	831,469	-	(146,949)	684,520
Total securities available for sale	$ 31,632,406	$ 963,646	$ (209,226)	$ 32,386,826
Securities held to maturity:				
U.S. Agency MBS's	640,692	26,763	-	667,455
Total securities held to maturity	$ 640,692	$ 26,763	$ -	$ 667,455

Net unrealized gains on available-for-sale investment securities totaling $160,000 were recorded, net of $112,000 in deferred tax liabilities, as accumulated other comprehensive income within shareholders' equity at December 31, 2010. Net unrealized gains on available-for-sale investment securities totaling $445,000 were recorded, net of $309,000 in deferred tax liabilities as accumulated other comprehensive income within shareholders' equity at December 31, 2009.

There were no transfers of available-for-sale investment securities during the year ended December 31, 2010 or December 31, 2009.

Proceeds from the sale of available-for-sale investment securities totaled $11,735,261 during 2010 and $2,685,051 for the year ended December 31, 2009.

The amortized cost and estimated fair value of investment securities at December 31, 2010 and December 31, 2009, 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, 2010	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	$ 501,073	$ 534,110	$ -	$ -
Due after one year through five years	5,056,890	5,008,990	-	-
Due after five years through ten years	997,369	1,025,572	-	-
Due after ten years	2,896,273	2,632,510	-	-
Mortgage-backed securities	16,067,875	16,589,823	451,765	470,665
Total	$ 25,519,480	$ 25,791,005	$ 451,765	$ 470,665

Investment securities in a temporary unrealized loss position as of December 31, 2010 and 2009 are shown in the following table, based on the time they have been continuously in an unrealized loss position:

December 31, 2010:	Less than 12 months		12 months or more		Total	
Securities available for sale:	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Agency Securities	$ 3,933,660	$ (66,340)	$ -	$ -	$ 3,933,660	$ (66,340)
U.S. Agency MBS's	1,183,362	(59,991)	-	-	1,183,362	(59,991)
Municipal	1,934,800	(122,963)	-	-	1,934,800	(122,963)
Corporate	-	-	697,710	(140,801)	697,710	(140,801)
	$ 7,051,822	$ (249,294)	$ 697,710	$ (140,801)	$ 7,749,532	$ (390,095)

December 31, 2009:	Less than 12 months		12 months or more		Total	
Securities available for sale:	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Agency MBS's	$ 3,980,000	$ (21,222)	$ -	$ -	$ 3,980,000	$ (21,222)
Municipal	-	-	464,000	(41,055)	464,000	(41,055)
Corporate	-	-	685,000	(146,949)	685,000	(146,949)
	$ 3,980,000	$ (21,222)	$ 1,149,000	$ (188,004)	$ 5,129,000	$ (209,226)

At December 31, 2010 the Bank held 37 investment securities of which 8 were in a loss position for less than twelve months, and 1 security was in a loss position for twelve months or more.

The unrealized losses on the Bank’s investments in U.S. Agency MBS, Municipals and Corporate were caused by changes in the yield curve after purchase. The contractual terms of these investments do not permit the issuer to settle the securities at a price less than the amortized cost of the investments. The

Bank has the intent and ability to hold these investments securities to a forecast recovery or maturity. Therefore, the Bank does not consider these investments to be other-than-temporarily impaired at December 31, 2010 and 2009.

There was a gross realized gain of $596,923 from the sale of securities during the year ended December 31, 2010 and $110,697 gross realized gain from the sale of securities during the year ended December 31, 2009. Investment securities pledged to secure public deposits and FHLB borrowing arrangements at December 31, 2010 and December 31, 2009, were $25,465,000 and $32,141,231, respectively.

NOTE 3. LOANS RECEIVABLE

The outstanding loan portfolio balances at December 31, 2010 and 2009 are as follows:

	December 31,	
	2010	2009
Commercial real estate	$ 78,837,418	$ 67,719,775
Land and construction	17,168,125	21,490,522
Commercial and industrial	49,072,260	30,651,572
Agricultural land, real estate and production	11,198,261	14,585,990
Consumer	25,174,724	22,077,374
Gross loans receivable	181,450,788	156,525,233
Deferred loan fees	(60,663)	(125,291)
Allowance for loan losses	(3,558,521)	(2,898,478)
Loans receivable, net	$ 177,831,604	$ 153,501,464
Loans at fixed interest rates	$ 24,249,942	$ 28,557,000
Loans at variable interest rates	157,200,846	127,968,233
	$ 181,450,788	$ 156,525,233

Non-accrual loans and leases totaled $4,106,548 at December 31, 2010. There were no non-accrual loans and leases as of December 31, 2009. There were no loans and leases past due 90 days or more and still accruing interest at December 31, 2010 and $602,006 at December 31, 2009. Interest income on non-accrual loans is generally recognized on a cash basis and was not significant for 2010 or 2009. Interest foregone on non-accrual loans was approximately $143,670 and $77,553 for the years ended December 31, 2010 and 2009, respectively.

The recorded investment in loans and leases that were considered to be impaired totaled $4,294,712 at December 31, 2010 and had a related valuation allowance of $274,662. There was no recorded investment in loans and leases that were considered to be impaired at December 31, 2009. The average recorded investment in impaired loans and leases was $2,330,576 and $2,453,000 at December 31, 2010 and 2009, respectively.

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, 2010 and December 31, 2009:

	December 31, 2010	December 31, 2009
Leasehold improvements	$ 1,843,918	$ 1,843,918
Furniture, fixtures and equipment	1,595,935	1,569,365
Software and capitalized data & item processing	208,249	196,693
Computer equipment	503,452	433,930
Total premises and equipment	4,151,554	4,043,905
Less accumulated depreciation and amortization	(2,486,693)	(1,991,771)
Premises and equipment, net	$ 1,664,861	$ 2,052,134

Depreciation and amortization expense aggregated $502,000 for the year ended December 31, 2010 and $544,000 for the year ended December 31, 2009.

NOTE 5. ALLOWANCE FOR LOAN AND LEASE LOSSES

Changes in the allowance for loan losses are as follows:

	December 31, 2010	December 31, 2009
Balance at beginning of year	$ 2,898,478	$ 2,885,298
Provision for loan losses	1,200,000	1,250,196
Loan charge-offs	(642,614)	(1,250,174)
Recoveries of loan charge-offs	102,657	13,158
Balance at year end	$ 3,558,521	$ 2,898,478

The following table shows the allocation of the allowance for loan losses at and for the year ended December 31, 2010 by portfolio segment and by impairment methodology:

Allowance for Credit Losses and Recorded Investment in Financing Receivables

For the Year Ended December 31, 2010

	Commercial Real Estate	Land and Construction	Commercial and Industrial	Agricultural Land, Real Estate and Production	Consumer	Unallocated	Total
Allowance for credit losses:							
Balance at beginning of year	$ 464,212	$ 1,511,972	$ 664,017	$ 10,600	$ 236,039	$ 11,638	$ 2,898,478
Provision for loan losses	378,514	(300,174)	714,851	37,707	215,888	153,214	1,200,000
Loan charge-offs	(100,274)	(219,959)	(215,734)	-	(106,647)	-	(642,614)
Recoveries of loan charge-offs	10,625	-	85,884	-	6,148	-	102,657
Balance at year end	$ 753,077	$ 991,839	$ 1,249,018	$ 48,307	$ 351,428	$ 164,852	$ 3,558,521
Ending balance: individually evaluated for impairment	$ 53,695	$ 182,500	$ 38,467	$ -	$ -	$ -	$ 274,662
Ending balance: collectively evaluated for impairment	$ 699,382	$ 809,339	$ 1,210,551	$ 48,307	$ 351,428	$ 164,852	$ 3,283,859
Loans outstanding:							
Balance at year end	$ 78,837,418	$ 17,168,125	$ 49,072,260	$ 11,198,261	$ 25,174,724	$ -	$ 181,450,788
Ending balance: individually evaluated for impairment	$ 242,316	$ 3,206,756	$ 76,934	$ -	$ 768,706	$ -	$ 4,294,712
Ending balance: collectively evaluated for impairment	$ 78,595,102	$ 13,961,369	$ 48,995,326	$ 11,198,261	$ 24,406,018	$ -	$ 177,156,076

The following table shows the loan portfolio allocated by management's internal risk ratings at December 31, 2010:

	Commercial Real Estate	Land and Construction	Commercial and Industrial	Agricultural Land, Real Estate and Production
Pass	$ 75,486,804	$ 10,095,490	$ 47,752,766	$ 11,198,261
Special Mention	2,494,413	752,255	908,908	-
Substandard	725,116	3,113,624	410,586	-
Doubtful	131,085	3,206,756	-	-
Total	$ 78,837,418	$ 17,168,125	$ 49,072,260	$ 11,198,261

	Consumer
Grade:	
Pass	$ 22,069,849
Special Mention	926,975
Substandard	2,177,900
Doubtful	-
Total	$ 25,174,724

The following table shows an aging analysis of the loan portfolio by the time past due at December 31, 2010:

	30-89 Days Past Due	90 Days and Still Accruing	Nonaccrual	Total Past Due	Current	Total
Commercial:						
Commercial Real estate	$ 137,254	$ -	$ 131,085	$ 268,339	$ 78,569,079	$ 78,837,418
Land and Construction	-	-	3,206,757	3,206,757	13,961,368	17,168,125
Commercial and industrial	-	-	-	-	49,072,260	49,072,260
Agricultural Land, Real Estate and Production	-	-	-		11,198,261	11,198,261
Consumer:	4,448	-	768,706	773,154	24,401,570	25,174,724
Total	$ 141,702	$ -	$ 4,106,548	$ 4,248,250	$ 177,202,538	$ 181,450,788

The following table shows information related to impaired loans at and for the year ended December 31, 2010:

Impaired Loans
For the Year ended December 31, 2010

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial Real estate	$ 131,085	$ 383,912	$ -	$ 97,296	$ -
Commercial and industrial	-	118,663	-	-	-
Consumer	768,706	869,411	-	217,525	-
Total	899,791	1,371,986	-	314,821	-
With an allowance recorded:					
Commercial Real estate	111,231	111,231	53,695	113,259	-
Land and Construction	3,206,756	3,426,716	182,500	1,703,506	-
Commercial and industrial	76,934	76,934	38,467	198,990	-
Total	3,394,921	3,614,881	274,662	2,015,755	-
Total:					
Commercial Real estate	242,316	495,143	53,695	210,555	-
Land and Construction	3,206,756	3,426,716	182,500	1,703,506	-
Commercial and industrial	76,934	195,597	38,467	198,990	-
Consumer	768,706	869,411	-	217,525	-
Total	$ 4,294,712	$ 4,986,867	$ 274,662	$ 2,330,576	$ -

The Bank has no commitments to lend additional funds to borrowers with loans whose terms have been modified in troubled debt restructurings.

NOTE 6. DEPOSITS

Interest-bearing deposits consisted of the following:

	December 31, 2010	December 31, 2009
NOW accounts	$ 25,240,662	$ 19,164,987
Money Market	50,538,071	55,703,733
Time deposits $100,000 or more	51,323,785	56,470,212
Time deposits less than $100,000	22,150,110	20,670,343
Savings	9,836,763	11,399,166
	$ 159,089,391	$ 163,408,441

At December 31, 2010 the scheduled maturities for all time deposits were as follows:

	December 31, 2010
One year or less	$ 72,463,750
Over one year through two years	433,628
Over two years through three years	277,836
Over three years through four years	83,110
Over four years through five years	215,571
	$ 73,473,895

As of December 31, 2010 and 2009, the Bank had brokered deposits totaling $400,000 and $1,522,000, respectively. Interest expense on time deposits of $100,000 or more was $405,675 and $644,098 in 2010 and 2009, respectively.

NOTE 7. BORROWED FUNDS

At December 31, 2010 and December 31, 2009, the Bank had 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 of San Francisco (“FHLB”). As of December 31, 2010, the Bank had $36,719,305 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 Bank recognized approximately one thousand dollars of borrowing expense in 2010 and 2009, respectively. The Bank had an available line of credit with the FHLB secured by the assets of the Bank. Under this line, the Bank may borrow up to $43,970,250 subject to providing adequate collateral and continued compliance with the Advances and Security Agreement and other eligibility requirements established by the FHLB. The Bank had no borrowed funds outstanding at December 31, 2010 and December 31, 2009 under these arrangements.

The accounting and reporting standards for transfers of financial assets set forth in FASB Accounting Standards Update ("ASU") 2009-16, Accounting for Transfers of Financial Assets (formerly FASB Statement No. 166). The transfer of SBA loans do not meet the conditions for sale treatment due to the participating interest in a partial transfer of a financial asset and therefore must account for the transfer as a secured borrowing with pledge of collateral. The Bank is required to report the transferred financial assets in its financial statements with no change in their measurement. Once the assets satisfy all of the conditions to be accounted for as a sale, the Bank recognizes the assets and measures them at fair value. The Bank had secured borrowings of $3,787,375 outstanding at December 31, 2010. There were loans held for sale of $18,676,191 included in Loans Receivable on the balance sheet at December 31, 2010.

NOTE 8. 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, 2010 and 2009 are as follows:

	2010	2009
Allowance for loan losses	$ 1,218,043	$ 979,000
Deferred compensation	673,231	567,000
Accruals	239,373	120,000
Current state income tax	148,898	13,000
Other deferred tax assets	158,827	69,000
Gross deferred tax assets	2,438,372	1,748,000
Less: valuation allowance	-	-
	2,438,372	1,748,000
Deferred loan costs	(229,440)	-
Fixed assets	(110,376)	(169,000)
Unrealized gain/loss and pension	(34,947)	(287,000)
Other deferred tax liabilities	(52,453)	(56,000)
Gross deferred tax liabilities	(427,216)	(512,000)
Net deferred tax asset	$ 2,011,156	$ 1,236,000

The provision for income taxes is as follows for the years ended December 31, 2010 and 2009:

	2010	2009
Current:		
Federal	$ 1,336,283	$ 67,781
State	360,446	38,006
Total current	1,696,729	105,787
Deferred:		
Federal	$ (432,177)	$ (5,000)
State	(90,926)	58,000
Total deferred	(523,103)	53,000
Total provision	$ 1,173,626	$ 158,787

The effective tax rate differs from the federal statutory rate as follows for the years ended December 31, 2010 and 2009:

	Year ended December 31, 2010	2009
Federal statutory rate	34.00%	34.00%
State income tax, net of federal effect	5.94%	6.88%
Stock based compensation	0.33%	12.73%
Bank owned life insurance	(1.56%)	(12.61%)
Split dollar expense	0.86%	0.86%
Other	(0.40%)	2.05%
Net	39.17%	43.91%

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 2007 to 2010 and 2006 to 2010, respectively, are currently open for examination.

NOTE 9. 401(K) EMPLOYEE BENEFIT 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. 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.

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. These provisions increased other liabilities by $341,199 with the offset reflected as a cumulative-effect adjustment to accumulated other comprehensive income in 2009. Total expense recognized during the year ending December 31, 2010 and December 31, 2009 was $75,511 and $9,117, respectively.

NOTE 10. 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 500,202 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 activity relating to the Bank's stock option plan as of December 31, 2010 and 2009 as presented below:

December 31, 2010

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value
Options outstanding at beginning of year	309,890	$12.41		
Granted	-	$0.00		
Exercised	-	$0.00		
Forfeited or expired	(28,500)	$14.18		
Options outstanding at end of year	281,390	$12.23	3.88 years	$217,140
Options exercisable	267,669	$11.97	3.69 years	$217,140

December 31, 2009

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value
Options outstanding at beginning of year	291,297	$12.38		
Granted	26,000	$13.01		
Exercised	(5,000)	$10.00		
Forfeited or expired	(2,407)	$20.03		
Options outstanding at end of year	309,890	$12.41	5.24 years	$0
Options exercisable	263,419	$11.73	3.69 years	$0

The number and weighted average grant date fair value of options granted is as follows for the year ended December 31, 2009. There were no options granted in 2010:

	Number	Weighted Average Grant Date Fair Value
2009	26,000	$4.04

There were no options exercised during 2010. The aggregate intrinsic value of options exercised for the year ended December 31, 2009 is $5,000.

The fair value of each option grant was estimated on the date of grant using the Black-Scholes option pricing model. There were no options granted in 2010 and the following weighted average assumptions used for 2009 are as follows:

	2009
Expected life (yrs.)	6.25
Volatility	27.22%
Risk free rate of return	1.85% - 3.07%
Dividend yield	0.00%

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, 2010 and 2009, no related party loans were on non-accrual or classified for regulatory reporting purposes.

Total extensions of credit made to or guaranteed by the Bank's directors and officers and their related companies totaled $2,511,178 and $1,261,178 at December 31, 2010 and December 31, 2009, respectively. Loan related activity to directors, officers and principal shareholders and their associates for the years ended December 31, 2010 and 2009 is as follows:

	2010	2009
Balance at beginning of year	$ 167,621	$ 262,677
New loans or disbursements	1,292,685	572,635
Principal repayments	(176,597)	(667,691)
Balance at end of year	$ 1,283,709	$ 167,621

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, 2010 and 2009.

	Year ended December 31, 2010	2009
Change in benefit obligation		
Benefit obligation at the beginning of the year	$ 1,433,021	$ 1,186,588
Service cost	158,662	138,386
Interest cost	90,583	78,173
Actuarial gains	140,210	29,874
Expected benefits paid	(30,588)	-
Projected benefit obligation at the end of the year	1,791,888	1,433,021
Funded status	(1,791,888)	(1,433,021)
Unrecognized net actuarial gain (loss)	139,720	(490)
Unrecognized prior service cost	46,890	55,370
(Accrued)/ prepaid benefit cost	(1,605,278)	(1,378,141)
Accrued Benefit Liability	(1,791,888)	(1,433,021)
Accumulated Other Comprehensive Expense	186,610	54,880
Net Amount Recognized	$ (1,605,278)	$ (1,378,141)
Weighted average assumptions to determine benefit obligation as of December 31:		
Discount rate	5.30%	5.90%
Rate of compensation increase	N/A	N/A

The components of net periodic benefit cost recognized for the years ended December 31, 2010 and 2009 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, 2011 are as follows:

	2011	Year ended December 31, 2010	2009
Components of net periodic benefit cost			
Service cost	$ 100,247	$ 116,240	$ 138,386
Interest Cost	99,210	90,583	78,173
Amortization of prior service cost	8,480	8,480	8,480
Net periodic benefit cost	$ 207,937	$ 215,303	$ 225,039

NOTE 13. RESTRICTIONS, COMMITMENTS, CONTINGENCIES AND OTHER DISCLOSURES

Retrictions 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 the Bank is required to keep on deposit at the Federal Reserve Bank, providing more funds for lending and investment purposes. The Bank had no reserve requirement at December 31, 2010 and December 31, 2009.

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 leases various office premises under long-term operating lease agreements. These leases expire on various dates through 2018 and have various renewal options of 5 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 an initial term of 5 years and the Bank exercised its option to extend for an additional period of three years during 2010.

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

Year ending December 31,	
2011	$ 550,740
2012	512,852
2013	462,952
2014	339,573
2015	302,123
Thereafter	691,653
	$ 2,859,893

Building and kiosk rent expense for the year ended December 31, 2010 and December 31, 2009, was approximately $566,000 and $529,000, 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 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, 2010 and December 31, 2009 are as follows:

	December 31, 2010	December 31, 2009
Commitments to extend credit	$ 48,078,422	$ 55,345,562
Standby letters of credit	2,899,655	2,163,391
	$ 50,978,077	$ 57,508,953

Legal Matters: The Bank is subject to certain legal proceedings arising in the normal course of business. At December 31, 2010, the Bank was not subject to any claims and/or lawsuits.

NOTE 14. OTHER NON-INTEREST 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, 2010	December 31, 2009
Other non-interest income:		
BOLI non-interest income	$ 137,713	$ 134,133
Merchant Processing Fees	208,771	191,744
SBA Servicing and Packaging Fees	207,083	149,745
ATM Fee Income	281,060	168,453
Other non-interest income	72,255	79,561
Total other non-interest income	$ 906,882	$ 723,636
Other non-interest expense:		
Stationery, supplies and printing	$ 125,546	$ 129,635
Armored car and messenger	82,333	101,890
Telephone, postage and electronic communication	144,629	137,044
Correspondent bank charges	186,993	142,736
Insurance and security	76,373	69,937
Loan and collection expense	245,307	168,231
ATM related expenses	164,217	124,379
Shareholder related expense	100,538	91,963
Other non-interest expenses	419,559	324,339
Total other non-interest expenses	$ 1,545,495	$ 1,290,154

NOTE 15. REGULATORY CAPITAL REQUIREMENTS AND OTHER REGULATORY MATTERS

Dividend Retrictions: When the Bank has earnings, 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. However, the Board has agreed not to pay any dividends without the prior approval of both the FDIC and the DFI.

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 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, 2010 and 2009, 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. As a result of a regulatory examination in 2010, the Bank became subject to a Tier 1 capital to average assets ratio of 8.25%. At December 31, 2010, this ratio was 8.30%.

(Dollars in thousands)	Actual		For Capital Adequacy Purposes:		To Be Well Capitalized Under the FDICIA Prompt Corrective Action	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2010						
Total capital (to risk weighted assets)	$ 26,304	13.54%	$ 15,536	8.00%	$ 19,421	10.00%
Tier 1 capital (to risk weighted assets)	$ 23,862	12.29%	$ 7,768	4.00%	$ 11,652	6.00%
Tier 1 capital (to average assets) leverage ratio	$ 23,862	8.30%	$ 11,501	4.00%	$ 14,376	5.00%
As of December 31, 2009						
Total capital (to risk weighted assets)	$ 21,892	11.57%	$ 15,135	8.00%	$ 18,919	10.00%
Tier 1 capital (to risk weighted assets)	$ 19,521	10.32%	$ 7,568	4.00%	$ 11,351	6.00%
Tier 1 capital (to average assets) leverage ratio	$ 19,521	7.37%	$ 10,597	4.00%	$ 13,246	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.

In 2010 the Bank offered for sale up to a maximum of 241,600 shares of its Common Stock, no par value ("Common Stock"), at a cash price of $10.35 per share. The Bank raised $2,478,796, net of $21,764 in offering expenses, in additional capital through the offering. The Offering was made only to qualified "accredited investors" and to no more than 35 "other investors." The Bank sold these shares through its officers and directors, and did not compensate securities dealers in connection with the Offering. The infusion of capital into the Bank improved regulatory capital ratios and will be used for general corporate purposes, and possibly expansion activities.

NOTE 16. FAIR VALUE OF FINANCIAL INSTRUMENTS

The following table presents the carrying amounts and estimated fair values of the Bank's financial instruments at December 31, 2010 and December 31, 2009. 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,			
	2010		2009	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial Assets:				
Cash and cash equivalents	$ 13,309,904	$ 13,309,904	$ 7,754,790	$ 7,754,790
Certificates of deposit	54,069,000	55,189,000	58,248,000	58,248,000
Securities available-for-sale	25,791,005	25,791,005	32,386,826	32,386,826
Securities held-to-maturity	451,765	470,665	640,692	667,455
Loans, net	177,831,604	179,924,000	153,501,464	161,524,499
Bankers' Bank stock, at cost	1,026,200	1,026,200	935,400	935,400
Accrued interest receivable	830,540	830,540	815,087	815,087
Bank owned life insurance	4,868,404	4,868,404	3,730,691	3,730,691
Financial Liabilities:				
Noninterest-bearing demand deposits	$ 94,326,653	$ 94,326,653	$ 75,895,196	$ 75,895,196
Interest-bearing demand deposits	25,240,662	25,240,662	19,164,987	19,164,987
Savings and money market deposits	60,374,834	60,374,834	67,102,899	67,102,899
Time certificates of deposit	73,473,895	73,489,000	77,140,555	77,055,540
Accrued interest payable	182,952	182,952	303,027	303,027
Other borrowings	3,787,375	3,787,375	3,000,000	3,000,000

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.

Certificates of Deposit: The fair values were calculated using cash flow model that compares the Bank’s yield to current market rates.

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, 2010 and December 31, 2009 approximate their current book values.

Bankers' Bank Stock: Bankers' Bank Stock includes Federal Home Loan Bank Stock and Pacific Coast Bankers Bank Stock. Carrying amount is a reasonable estimate of fair value. The Federal Home Loan Bank investment is carried at cost and is redeemable at par with certain restrictions.

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 Borrowings: Other borrowings included secured borrowings as required under FASB Accounting Standards Update ("ASU") 2009-16, Accounting for Transfers of Financial Assets (formerly FASB Statement No. 166). The carrying amount is a reasonable estimate of 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 – 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 – Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable or can be corroborated by observable market data.

Level 3 – Model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect the Bank's estimates of assumptions that market participants would use on pricing the asset or liability. Valuation techniques include management judgment and estimation which may be significant.

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.

Assets Recorded at Fair Value

The following tables present information about the Bank's assets and liabilities measured at fair value on a recurring and nonrecurring basis as of December 31, 2010 and 2009:

Recurring Basis

	2010			
	Fair Value	Level 1	Level 2	Level 3
Securities available for sale:				
U.S. Agency Securities	$ 3,933,660	$ -	$ 3,933,660	$ -
U.S. Agency MBS's	16,589,523	-	16,589,523	-
Municipal	4,570,112	-	4,570,112	-
Corporate	697,710	-	697,710	-
Total assets measured at Fair Value	$ 25,791,005	$ -	$ 25,791,005	$ -

	2009			
	Fair Value	Level 1	Level 2	Level 3
Securities available for sale:				
U.S. Agency Securities	$ 2,018,580	$ -	$ 2,018,580	$ -
U.S. Agency MBS's	24,423,479	-	24,423,479	-
Municipal	5,260,247	-	5,260,247	-
Corporate	684,520	-	684,520	-
Total assets measured at Fair Value	$ 32,386,826	$ -	$ 32,386,826	$ -

Fair values for available-for-sale investment securities are based on quoted market prices for similar securities. During the year ended December 31, 2010, 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 2010.

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, 2010			
	Fair Value	Level 1	Level 2	Level 3
Impaired loans	$ 4,020,050	$ -	$ 4,020,050	$ -
Real estate owned	1,358,403	-	1,358,403	-
Total assets measured at Fair Value	$ 5,378,453	$ -	$ 5,378,453	$ -

	December 31, 2009			
	Fair Value	Level 1	Level 2	Level 3
Real estate owned	$ 1,294,789	$ -	$ 1,294,789	$ -
Total assets measured at Fair Value	$ 1,294,789	$ -	$ 1,294,789	$ -

Impaired Loans: The fair value of impaired loans is based on the fair value of collateral.

Real Estate Owned: Real estate owned represents real estate which the Bank has taken control of in partial or full satisfaction of loans. The fair value of real estate owned is based on property appraisals at the time of transfer and as appropriate thereafter, less costs to sell.

SANTA CRUZ COUNTY BANK FOUNDERS AND DIRECTORS

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.

OUR BANK FOUNDERS

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

*denotes Bank Directors

Our Board pictured left to right, David V. Heald, Gary A. Reece, Tila Guerrero, William J. Hansen (Vice-Chairman), George R. Gallucci (Chairman), Thomas N. Griffin, Kenneth R. Chappell, and Steven G. John

OUR BOARD OF DIRECTORS

Kenneth R. Chappell, CPA, Partner-In-Charge, Hutchinson & Bloodgood, LLP
George R. Gallucci, (Chairman), Director of Client Relations, Scharf Investments
Thomas N. Griffin, Director & President, Grunsky, Ebey, Farrar & Howell
Tila Guerrero, President & CEO, Mas Mac Inc., McDonald's Restaurants
William J. Hansen, (Vice-Chairman), President & CEO, Hansen Insurance Co.
David V. Heald, President & CEO, Santa Cruz County Bank
Steven G. John, President, Ocean Speedway
Gary A. Reece, President, The ATG Group

SANTA CRUZ COUNTY BANK MANAGEMENT

David V. Heald, President & Chief Executive Officer

Frederick L. Caiocca, Executive Vice President & Chief Credit Officer

Vic Davis, Senior Vice President & Chief Financial Officer

Mary Anne Carson, Senior Vice President, Director of Marketing & Community Relations

Susan Chandler, Senior Vice President, SBA Department Manager

Angelo DeBernardo, Jr., Senior Vice President, Senior Lending Officer

Carol Grove, Senior Vice President, Operations Administrator

Heather LaFontaine, Vice President, Risk Management Officer and Human Resources Manager

Jaime Manriquez, Vice President, Chief Technology Officer and Information Security Officer

Janice Zappa, Vice President, Corporate Secretary

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 Branch Locations

Clockwise left to right: Santa Cruz, Capitola, Aptos, Scotts Valley, and Watsonville.

BANKING LOCATIONS:

APTOS

7775 Soquel Drive
Aptos, CA 95003

662.6000

CAPITOLA

819 Bay Avenue
Capitola, CA 95010

464.5300

SANTA CRUZ

720 Front Street
Santa Cruz, CA 95060

457.5000

SCOTTS VALLEY

4604 Scotts Valley Drive
Scotts Valley, CA 95066

461.5000

WATSONVILLE

595 Auto Center Drive
Watsonville, CA 95076

761.7600

ATM & NIGHT DEPOSITORY LOCATIONS:

SANTA CRUZ (At Dominican Hospital Campus)

APTOS (At Deluxe Foods of Aptos)

831.457.5000

www.sccountybank.com