2011 Annual Report

SANTA CRUZ COUNTY BANK

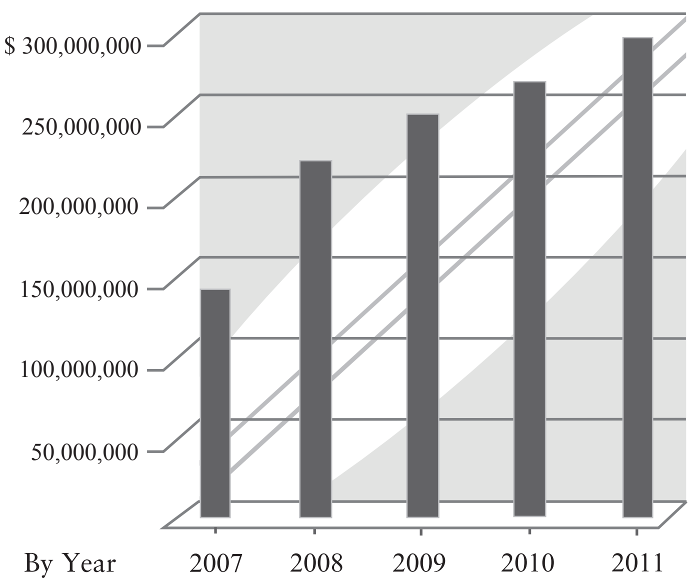
Put Your Money Where Your Life Is.

LOCAL BANKING AT ITS BEST

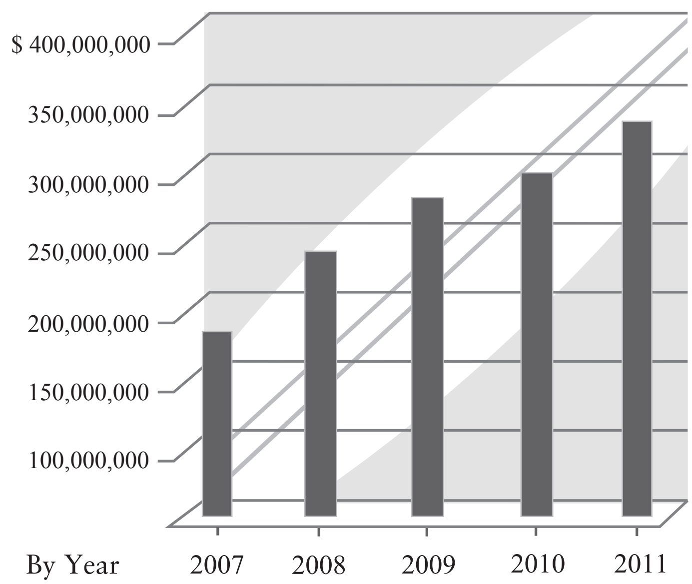
Celebrating 8 Years of serving our community

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

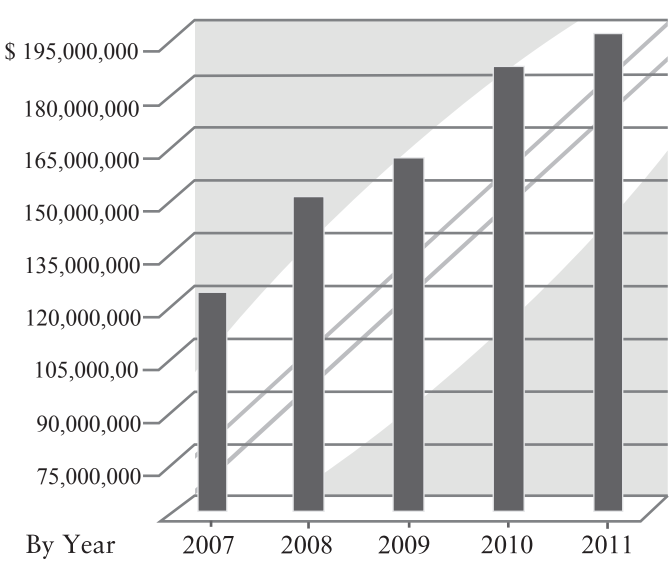
TOTAL DEPOSITS



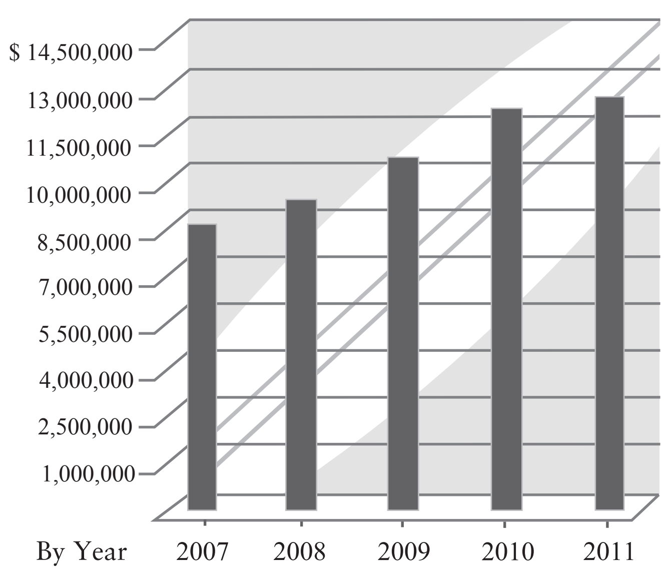
TOTAL ASSETS



GROSS LOANS



NET INTEREST INCOME



LETTER TO SHAREHOLDERS

To Our Shareholders,

It is our pleasure to present our Annual Report and highlights for 2011.

We enter our ninth year of serving Santa Cruz County with optimism and strong momentum. We ended 2011 with a 33% increase in net income and double digit growth in deposits and assets. Once again, we have proven our ability to make necessary strategic adjustments to maximize efficiency and control expenses to maintain shareholder value even through the most challenging economic times. Our delivery of strong financial performance is a testimony to our focus and ability to deliver consistent growth and value.

A preferred SBA lender since 2005, Santa Cruz County Bank has expanded its array of loan products to include Business and Industry lending and Farm Service Agency lending through the USDA. We have made noteworthy achievements in our SBA and government guaranteed lending programs which led to recognition in top 10 lending rankings above many major banks in our market area. Additionally, our focus on lending to health and medical professionals as well as to businesses in the agricultural related industry, garnered the attention of media and national representatives who champion the USDA's programs for lending and resulted in word of mouth referrals for a job well done.

Our mission to be the *bank of choice* in our community has taken hold. In 2011, our deposits grew by $35 million over the prior year. Building on this strong foundation, we look to become the community's *lender of choice*. Throughout 2011 and into 2012, the Bank's focus on growing our earning assets through loans intensified. National economic uncertainty and the overall drop in real estate and franchise values have led to a significantly more competitive lending marketplace than ever before. Through targeted marketing, networking and word of mouth, we are actively establishing the Bank as a business lender.

2011 Highlights

- The Bank received the designation of Super Premier Performer for its 2011 performance by the Findley Reports, Inc., a highly regarded financial industry consulting firm.

- The Bank achieved three "Excellent" 4-star and one "Superior" 5-star rating from Bauer Financial Inc. for its quarterly financial performance.

- Total assets reached $320 million, a historic milestone.

- Net income before tax exceeded $3.9 million for 2011.

2011 Highlights - continued

- As of June 30, 2011, the Bank's market share of deposits held by FDIC insured institutions in the County of Santa Cruz increased to 6.40% from 6.07% the prior year.

- Santa Cruz County Bank ranked 7th in the number of SBA 7(a) and 504 loan approvals in Silicon Valley* for the 2011 SBA fiscal year. *Silicon Valley includes Alameda, San Mateo, Santa Clara and Santa Cruz counties.

As always, we welcome your business referrals which help build our Bank, and we value your continued support and confidence.

George Gallucci
Chairman of the Board

David Heald
President & CEO

BOARD OF DIRECTORS CHANGE IN 2012

In May of 2012, the Board of Directors will extend a fond farewell to original Founder and Director of the Bank, Steve John. Steve's resignation from the Board is the result of his acceptance of a new role as CEO of the Monterey Peninsula Foundation, a non profit organization which stages the AT & T Pebble Beach National Pro-Am. Steve's participation, support, and guidance throughout the years will always be remembered and deeply appreciated. In anticipation of Steve's departure from the Board, we have seated a new Board member.

The Board of Directors of Santa Cruz County Bank are pleased to advise you of the appointment of Harvey J. Nickelson to serve on the Bank's Board. We are very fortunate to have another individual with considerable banking expertise and deep community connections join our Board. Harvey was the founding President and CEO of Coast Commercial Bank. His extensive knowledge, industry insight and financial acuity will add strength to our Board. With long term business and community connections, Harvey will be another great resource for attracting new relationships to the Bank. We welcome him and look forward to his contributions to our Board and Bank.

Crowe Horwath

Crowe Horwath LLP
Independent Member Crowe Horwath International

REPORT OF INDEPENDENT AUDITORS

To the Audit Committee
Santa Cruz County Bank
Santa Cruz, California

We have audited the accompanying balance sheet of Santa Cruz County Bank (the "Bank") as of December 31, 2011, and the related statements of income, changes in stockholders' equity and comprehensive income and cash flows for the year 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 audit. The 2010 financial statements of Santa Cruz County Bank were audited by Perry-Smith LLP, who combined with Crowe Horwath LLP as of November 1, 2011, and whose report dated March 15, 2011 expressed an unqualified opinion on those financial statements.

We conducted our audit in accordance with the 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 audit provides a reasonable basis for our opinion.

In our opinion, the 2011 financial statements referred to above present fairly, in all material respects, the financial position of Santa Cruz County Bank as of December 31, 2011, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Crowe Horwath LLP

Crowe Horwath LLP

San Francisco, California
March 20, 2012

SANTA CRUZ COUNTY BANK

BALANCE SHEETS
December 31, 2011 and 2010

	December 31, 2011	December 31, 2010
ASSETS		
Cash and due from banks	$ 8,597,352	$ 6,217,086
Federal funds sold	-	7,092,818
Total cash and cash equivalents	8,597,352	13,309,904
Certificates of deposit in other financial institutions	64,232,000	54,069,000
Securities available for sale	44,840,223	25,791,005
Securities held to maturity	297,210	451,765
Total investment securities	45,137,433	26,242,770
Loans held for sale	17,102,575	18,354,576
Loans receivable (net of allowance for loan losses of $4,305,290 at December 31, 2011 and $3,558,521 at December 31, 2010)	170,043,808	159,477,028
Bankers' Bank stock, at cost	1,100,100	1,026,200
Premises and equipment, net	1,290,354	1,664,861
Accrued interest receivable	1,003,634	830,540
Bank owned life insurance	5,037,184	4,868,404
Deferred income tax	2,225,274	2,011,156
Other real estate owned	2,931,889	1,358,403
Other assets	1,528,601	1,693,361
TOTAL ASSETS	$ 320,230,204	$ 284,906,203
LIABILITIES AND SHAREHOLDERS' EQUITY		
LIABILITIES		
Non-interest bearing deposits	$ 113,014,682	$ 94,326,653
Interest bearing deposits	175,192,232	159,089,391
Total deposits	288,206,914	253,416,044
Accrued interest payable	114,419	182,952
Other borrowings	2,000,000	3,787,375
Other liabilities	3,623,827	3,949,480
Total liabilities	293,945,160	261,335,851
Commitments and contingent liabilities (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; issued and outstanding; 1,922,940 shares at December 31, 2011 and 1,908,940 December 31, 2010	21,103,659	21,103,659
Additional paid-in capital	711,578	620,655
Retained earnings	4,566,417	2,137,215
Accumulated other comprehensive loss	(96,610)	(291,177)
Total shareholders' equity	26,285,044	23,570,352
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 320,230,204	$ 284,906,203

See notes to Financial Statements

SANTA CRUZ COUNTY BANK

STATEMENTS OF INCOME
Years ended December 31,

	2011	2010
INTEREST AND DIVIDEND INCOME:		
Loans, including fees	$ 10,874,383	$ 10,287,399
Interest bearing deposits in other financial institutions	1,011,685	1,319,367
Investment securities	865,257	1,034,896
Federal funds sold	21,818	11,540
Total interest and dividend income	12,773,143	12,653,202
INTEREST EXPENSE:		
Deposits	576,227	967,804
Borrowings	579	1,078
Total interest expense	576,806	968,882
Net interest income before provision for loan losses	12,196,337	11,684,320
Provision for loan losses	1,412,500	1,200,000
Net interest income after provision for loan losses	10,783,837	10,484,320
NON-INTEREST INCOME:		
Service charges on deposits	718,057	700,165
Net gains on sales of loans	1,001,439	560,719
Net gains on sales of securities	782,765	596,923
Other non-interest income	1,064,231	906,882
Total non-interest income	3,566,492	2,764,689
NON-INTEREST EXPENSE:		
Compensation and employee benefits	5,606,126	5,610,231
Occupancy	1,016,818	1,062,574
Furniture and equipment	389,620	405,324
Marketing and business development	264,280	235,696
Data and item processing	464,034	424,315
Professional services	372,209	356,886
Regulatory assessments	412,198	616,620
Provision for (benefit from) off balance sheet commitments	14,896	(4,453)
Other non-interest expenses	1,875,170	1,545,495
Total non-interest expense	10,415,351	10,252,688
Income before income taxes	3,934,978	2,996,321
Provision for income taxes	1,505,776	1,173,626
Net income	$ 2,429,202	$ 1,822,695
BASIC EARNINGS PER SHARE	$ 1.27	$ 1.08
DILUTED EARNINGS PER SHARE	$ 1.25	$ 1.08
Basic weighted average shares outstanding	1,908,940	1,695,141
Diluted weighted average shares outstanding	1,941,590	1,695,141

See notes to Financial Statements

SANTA CRUZ COUNTY BANK

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY AND COMPREHENSIVE INCOME
Years ended December 31,

	Common Stock		Additional Paid In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
	Shares	Amount				
Balance at January 1, 2010	1,667,340	$ 18,624,863	$ 581,516	$ 314,520	$ 72,079	$ 19,592,978
Comprehensive income:						
Net income				1,822,695		1,822,695
Other comprehensive income:						
Amortization of pension cost					(77,929)	(77,929)
Change in unrealized gain on securities available for sale, net of tax of $53,801					(285,327)	(285,327)
Total other comprehensive loss:						(363,256)
Total comprehensive income						1,459,439
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
Balance at December 31, 2010	1,908,940	$ 21,103,659	$ 620,655	$ 2,137,215	$ (291,177)	$ 23,570,352
Comprehensive income:						
Net income				2,429,202		2,429,202
Other comprehensive income:						
Amortization of pension cost					12,225	12,225
Change in unrealized gain on securities available for sale, net of tax of $127,525					182,342	182,342
Total other comprehensive income:						194,567
Total comprehensive income						2,623,769
Restricted stock awards and related expense	14,000		25,900			25,900
Share-based compensation			65,023			65,023
Balance at December 31, 2011	1,922,940	$ 21,103,659	$ 711,578	$ 4,566,417	$ (96,610)	$ 26,285,044

SANTA CRUZ COUNTY BANK

STATEMENTS OF CASH FLOWS
Years ended December 31,

	2011	2010
Cash flows from operating activities		
Net income	$ 2,429,202	$ 1,822,695
Adjustments to reconcile net income to net cash from operating activities:		
Deferred income tax benefit	(350,191)	(523,103)
Depreciation and amortization of premises and equipment	446,074	501,829
Net amortization of securities	779,456	374,585
Net loan amortization and accretion	14,552	9,483
Provision for loan losses	1,412,500	1,200,000
Provision for (reduction of) unfunded loan commitments	14,896	(4,453)
Earnings on bank owned life insurance	(168,780)	(137,713)
Net realized gain on sales of securities	(782,765)	(596,923)
Net gain on sales of loans	(1,001,439)	(560,719)
Loss on sale/writedowns of OREO	205,660	148,254
Net (gain) loss on sale/disposal of assets	35,257	(367)
Stock based compensation expense	90,923	39,139
Deferred benefit expense	270,857	333,236
Originations of loans held for sale	(6,006,719)	(14,898,759)
Proceeds from loans held for sale	8,581,774	7,911,769
Increase in accrued interest receivable	(173,094)	(15,453)
Increase in deferred loan fees, net of costs	(142,780)	(65,128)
Decrease in other assets	164,760	815,959
Decrease in accrued interest payable	(68,533)	(120,075)
(Decrease) increase in other liabilities	(590,634)	582,731
Net cash provided by (used in) operating activities	5,160,976	(3,183,013)
Cash flows from investing activities		
Principal repayments on securities held to maturity	154,122	188,032
Proceeds from the sale of securities available for sale	18,410,822	11,735,261
Proceeds from matured and called securities available for sale	3,000,000	2,000,000
Principal repayments on securities available for sale	5,096,310	5,507,434
Purchases of securities available for sale	(45,242,740)	(12,906,535)
Redemption of certificates of deposit in other financial institutions	27,413,000	43,449,000
Purchase of certificates of deposit in other financial institutions	(37,576,000)	(39,270,000)
Purchases of Federal Home Loan Bank stock	(73,900)	(90,800)
Purchase of bank owned life insurance	-	(1,000,000)
Net proceeds from sales of OREO	1,188,091	-
Net increase in loans	(18,927,279)	(14,351,279)
Purchases of premises and equipment	(106,824)	(114,589)
Proceeds from sale of assets	-	400
Net cash used by investing activities	(46,664,398)	(4,853,076)
Cash flows from financing activities		
Proceeds from stock offering, net of expenses	-	2,478,796
Proceeds from borrowings	27,060,000	26,435,000
Repayments of borrowings	(25,060,000)	(29,435,000)
Net Increase in deposits	34,790,870	14,112,407
Net cash provided by financing activities	36,790,870	13,591,203
Net (decrease) increase in cash and cash equivalents	(4,712,552)	5,555,114
Cash and cash equivalents at beginning of period	13,309,904	7,754,790
Cash and cash equivalents at end of period	$ 8,597,352	$ 13,309,904
Supplemental cash flow information		
Interest paid	$ 645,339	$ 1,088,957
Income taxes paid	2,330,000	1,635,834
Supplemental noncash disclosures		
Transfer of loans to other real estate owned	3,389,721	211,868

See Notes to Financial Statements

SANTA CRUZ COUNTY BANK

NOTES TO FINANCIAL STATEMENTS

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

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 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 became 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, 2011, the Bank had loans outstanding of approximately $138,699,000 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 allowance for loan losses, loan servicing rights, deferred tax assets, and fair values of financial instruments are particularly subject to change.

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, collateralized mortgage obligations, 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, 2011 and December 31, 2010, 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 level yield method, except for securities with early call provisions, in which case premiums are recognized in interest income using the straight line method over the period to the first call date and discounts are recognized in interest income using the straight line 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.

Loans Held for Sale: Loans originated and intended for sale are carried at the lower of aggregate cost or fair value. After a transfer of financial assets, the Bank 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 interest-only strip and the sold portion of the loan, based on the relative fair market value of each portion. If the loans are sold with servicing retained, the fair value of the servicing asset or liability is recorded on the balance sheet. 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 underlying terms of the loan. The servicing asset is amortized over an estimated life using a method approximating the level yield method; in the event future prepayments exceed Management’s estimates and future expected cash flows are inadequate to cover the unamortized servicing asset, additional amortization would be recognized. The portion of excess servicing fees in excess of the contractual servicing fees is reflected as interest-only (I/O) strips receivable, which are classified as interest-only strips receivable available-for-sale and are carried at fair value.

Loans: Loans that Management has the intent and ability to hold for the foreseeable future are reported 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.

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.

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. Typically, loans below $100,000 from all class types are excluded from individual impairment analysis.

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

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

The Bank maintains a separate allowance for each portfolio segment (loan type). These portfolio segments include commercial real estate, land and construction, commercial and industrial, agricultural land, real estate and production, and consumer loans (principally home equity loans). 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 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. This analysis includes loans with an outstanding balance greater than $300,000 and non-homogeneous loans, such as commercial and commercial real estate loans. This analysis is performed on an annual basis. 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 may result in troubled loans. Loans secured by crop production and livestock are especially vulnerable to two risk factors that are largely outside the control of Bank and borrowers: commodity prices and weather conditions.

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

Although Management believes the allowance to be adequate, ultimate losses may vary from its estimates. At least quarterly, the Board of Directors reviews the adequacy of the allowance, including consideration of the relative risks in the portfolio, current economic conditions and other factors. If the Board of Directors and Management determine that changes are warranted based on those reviews, the allowance is adjusted. In addition, the Bank's primary regulators, FDIC and California Department of 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.

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 payments are recorded on the loan. The amortization of servicing rights is netted against loan servicing income.

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 $2,931,889 and $1,358,403 in foreclosed real estate at December 31, 2011 and December 31, 2010, respectively.

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 balance sheet.

Premises and 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 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.

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 $930,100 and $856,200 as of December 31, 2011 and 2010, 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. Both cash and stock dividends, if any, are negotiated as income.

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

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 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, 2011 and 2010.

Stock-Based Compensation: The Bank has a share-based compensation plan for employees and directors, the 2003 Stock Option Plan (the "Option Plan"), which has been approved by its shareholders. The plan permits the grant of stock options for up to 500,202 shares of the Bank's common stock. The amount, frequency, and terms of share-based awards may vary based on competitive practices, the Bank's operating results and government regulations. New shares are issued upon option exercise under the 2003 Stock Option Plan and 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 Option Plan is designed to attract and retain employees and directors.

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.

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

No stock-based compensation costs were capitalized as part of the cost of an asset as of December 31, 2011. As of December 31, 2011, $59,351 of total unrecognized compensation cost related to stock options is expected to be recognized over a weighted-average period of 4 years.

Earnings Per Common 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.

There were 286,090 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 the year ended December 31, 2011.

Comprehensive Income: Comprehensive income is reported in addition to net income for all periods presented. Comprehensive income is a more inclusive financial reporting methodology that includes disclosure of other comprehensive income 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 and unrealized gains and losses on the Bank’s available-for-sale investment securities, adjusted for realized gains or losses included in net income. Total comprehensive income and the components of accumulated other comprehensive income are presented in the statement of changes in shareholders’ equity and comprehensive income.

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.

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

Adoption of New Accounting Standards

In April 2011, the Financial Accounting Standards Board ("FASB") amended existing guidance for assisting a creditor in determining whether a restructuring is a troubled debt restructuring. The amendments clarify the guidance for a creditor's evaluation of whether it has granted a concession and whether a debtor is experiencing financial difficulties. With regard to determining whether a concession has been granted, the Account Standard Update ("ASU") clarifies that creditors are precluded from using the effective interest method to determine whether a concession has been granted. In the absence of using the effective interest method, a creditor must now focus on other considerations such as the value of the underlying collateral, evaluation of other collateral or guarantees, the debtor's ability to access other funds at market rates, interest rate increases and whether the restructuring results in a delay in payment that is insignificant. The adoption of this guidance did not have a material effect on the Bank's operating results or financial condition. No additional troubled debt restructurings were identified as a result of adoption.

In May, 2011, the FASB issued an amendment to achieve common fair value measurement and disclosure requirements between U.S. and International accounting principles. Overall, the guidance is consistent with existing U.S. accounting principles; however, there are some amendments that change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. The Bank is currently evaluating the impact of this amendment on the financial statements.

In June 2011, the FASB amended existing guidance and eliminated the option to present the components of other comprehensive income as part of the statement of changes in shareholder's equity. The amendment requires that comprehensive income be presented in either a single continuous statement or in two separate consecutive statements. Early adoption is permitted. The adoption of this amendment will change the presentation of the components of comprehensive income for the Bank as part of the statement of shareholder's equity.

Subsequent Events
The Bank has reviewed all events occurring from December 31, 2011 through March 20, 2012, the date the financial statements were available to be issued and no subsequent events occurred requiring accrual or disclosure.

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, 2011, and December 31, 2010 and the corresponding amounts of gross unrealized gains and losses recognized in accumulated other comprehensive income (loss) and gross unrecognized gains and losses:

December 31, 2011	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Securities available for sale:				
U.S. government sponsored agencies	$ 2,081,069	$ 22,781	$ -	$ 2,103,850
U.S. government sponsored MBS's: residential	27,494,891	379,203	(133,970)	27,740,124
Municipal	13,836,939	451,237	(17,367)	14,270,809
Corporate	845,931	-	(120,491)	725,440
Total securities available for sale	$ 44,258,830	$ 853,221	$ (271,828)	$ 44,840,223

	Amortized Cost	Gross Unrecognized Gains	Gross Unrecognized Losses	Estimated Fair Value
Securities held to maturity:				
U.S. government sponsored MBS's: residential	297,210	16,553	-	313,763
Total securities held to maturity	$ 297,210	$ 16,553	$ -	$ 313,763

December 31, 2010	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Securities available for sale:				
U.S. government sponsored agencies	$ 4,000,000	$ -	$ (66,340)	$ 3,933,660
U.S. government sponsored MBS's: residential	12,193,066	453,711	(59,991)	12,586,786
U.S. government sponsored MBS's: commercial	3,874,809	127,928	-	4,002,737
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

	Amortized Cost	Gross Unrecognized Gains	Gross Unrecognized Losses	Estimated Fair Value
Securities held to maturity:				
U.S. government sponsored MBS's: residential	451,765	18,900	-	470,665
Total securities held to maturity	$ 451,765	$ 18,900	$ -	$ 470,665

Net unrealized gains on available-for-sale investment securities totaling $342,000 were recorded, net of $239,000 in deferred tax liabilities, as accumulated other comprehensive income within shareholders' equity at December 31, 2011. 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.

There were no transfers of available-for-sale investment securities during the year ended December 31, 2011 or December 31, 2010.

Proceeds from the sale of available-for-sale investment securities totaled $18,410,822 during 2011 and $11,735,261 for the year ended December 31, 2010.

The amortized cost and estimated fair value of investment securities at December 31, 2011 and December 31, 2010, by contractual maturity, are shown in the following table, except for mortgage-backed securities and other securities which are not due at a single maturity date 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, 2011	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Within one year	$ 500,515	$ 511,890		
One to five years	2,033,857	2,072,330		
Five to ten years	4,052,062	4,258,965		
Beyond ten years	10,177,505	10,256,914		
Mortgage-backed securities	27,494,891	27,740,124	297,210	313,763
Total	$ 44,258,830	$ 44,840,223	$ 297,210	$ 313,763

Investment securities pledged to secure public deposits and FHLB borrowing arrangements at December 31, 2011 and December 31, 2010, were $38,006,000 and $25,465,000, respectively. At year-end 2011 and 2010, there were no holdings of securities of any one issuer, other than the U.S. Government and its agencies, in an amount greater than 10% of shareholders' equity.

Investment securities in a temporary unrealized loss position as of December 31, 2011 and 2010 are shown in the following table, based on the time they have been continuously in an unrealized loss position:

December 31, 2011:	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. government sponsored MBS's	$ 10,920,466	$ (133,970)	$ -	$ -	$ 10,920,466	$ (133,970)
Municipal	1,266,915	(4,062)	490,525	(13,305)	1,757,440	(17,367)
Corporate	-	-	725,440	(120,491)	725,440	(120,491)
	$ 12,187,381	$ (138,032)	$ 1,215,965	$ (133,796)	$ 13,403,346	$ (271,828)

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. government sponsored agencies	$ 3,933,660	$ (66,340)	$ -	$ -	$ 3,933,660	$ (66,340)
U.S. government sponsored 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)

At December 31, 2011 the Bank held 65 investment securities of which 12 were in a loss position for less than twelve months, and 2 securities were in a loss position for twelve months or more.

The unrealized losses on the Bank's investments in U.S. government sponsored MBS, Municipals and Corporate were caused by changes in the yield curve after purchase and uncertain economic conditions. 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, 2011 and 2010.

There was a gross realized gain of $782,765 from the sale of securities during the year ended December 31, 2011 and $596,923 gross realized gain from the sale of securities during the year ended December 31, 2010.

NOTE 3. LOANS RECEIVABLE

The outstanding loan portfolio balances at December 31, 2011 and 2010 are as follows:

	December 31, 2011	December 31, 2010
Commercial real estate	$ 73,195,511	$ 64,088,228
Land and construction	12,308,393	17,168,125
Commercial and industrial	53,681,743	45,466,874
Agricultural land, real estate and production	11,154,197	11,198,261
Consumer	23,927,137	25,174,724
Gross loans receivable	174,266,981	163,096,212
Deferred loan fees, net	82,117	(60,663)
Allowance for loan losses	(4,305,290)	(3,558,521)
Loans receivable, net	$ 170,043,808	$ 159,477,028

	December 31, 2011	December 31, 2010
Commercial real estate	$ 9,422,469	$ 14,749,190
Land and construction	2,126,842	-
Commercial and industrial	5,450,429	3,605,386
Agricultural land, real estate and production	102,835	-
Loans held for sale	$ 17,102,575	$ 18,354,576

NOTE 4. ALLOWANCE FOR LOAN LOSSES

The following table shows the allocation of the allowance for loan losses at and for the years ended December 31, 2011 and December 31, 2010 by portfolio segment and by impairment methodology:

**Allowance for Loan Losses and Recorded Investment in Loans
For the Year Ended December 31, 2011**

	Commercial Real Estate	Land and Construction	Commercial and Industrial	Agricultural Land, Real Estate and Production	Consumer	Unallocated	Total
Allowance for loan losses:							
Balance at beginning of year	$ 753,077	$ 991,839	$ 1,249,018	$ 48,307	$ 351,428	$ 164,852	$ 3,558,521
Provision for loan losses	650,150	444,370	446,643	7,853	28,336	(164,852)	1,412,500
Loan charge-offs	(93,022)	(510,210)	(144,866)	-	-	-	(748,098)
Recoveries of loan charge-offs	-	29,230	47,171	-	5,966	-	82,367
Balance at year end	$ 1,310,205	$ 955,229	$ 1,597,966	$ 56,160	$ 385,730	$ -	$ 4,305,290
Ending balance: individually evaluated for impairment	$ 137,932	$ 388,197	$ 55,789	$ -	$ -	$ -	$ 581,918
Ending balance: collectively evaluated for impairment	$ 1,172,273	$ 567,032	$ 1,542,177	$ 56,160	$ 385,730	$ -	$ 3,723,372
Loans outstanding:							
Balance at year end	$ 73,195,511	$ 12,308,393	$ 53,681,743	$ 11,154,197	$ 23,927,137	$ -	$ 174,266,981
Ending balance: individually evaluated for impairment	$ 653,180	$ 3,725,098	$ 369,993	$ -	$ -	$ -	$ 4,748,271
Ending balance: collectively evaluated for impairment	$ 72,542,331	$ 8,583,295	$ 53,311,750	$ 11,154,197	$ 23,927,137	$ -	$ 169,518,710

**Allowance for Loan Losses and Recorded Investment in Loans
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 loan 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	$ 64,088,228	$ 17,168,125	$ 45,466,874	$ 11,198,261	$ 25,174,724	$ -	$ 163,096,212
Ending balance: individually evaluated for impairment	$ 242,316	$ 3,206,756	$ 76,934	$ -	$ 768,706	$ -	$ 4,294,712
Ending balance: collectively evaluated for impairment	$ 63,845,912	$ 13,961,369	$ 45,389,940	$ 11,198,261	$ 24,406,018	$ -	$ 158,801,500

The following table shows the loan portfolio allocated by Management's internal risk ratings at December 31, 2011 and December 31, 2010:

	Commercial Real Estate 2011	Land and Construction 2011	Commercial and Industrial 2011	Agricultural Land, Real Estate and Production 2011
Pass	$ 69,651,133	$ 8,583,295	$ 52,842,213	$ 11,154,197
Special Mention	2,891,198	-	405,886	-
Substandard	653,180	3,725,098	433,644	-
Doubtful	-	-	-	-
Total	$ 73,195,511	$ 12,308,393	$ 53,681,743	$ 11,154,197

	Commercial Real Estate 2010	Land and Construction 2010	Commercial and Industrial 2010	Agricultural Land, Real Estate and Production 2010
Pass	$ 60,737,614	$ 10,095,490	$ 44,147,380	$ 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	$ 64,088,228	$ 17,168,125	$ 45,466,874	$ 11,198,261

	Consumer 2011
Grade:	
Pass	$ 21,818,421
Special Mention	1,192,889
Substandard	915,827
Total	$ 23,927,137

	Consumer 2010
Grade:	
Pass	$ 22,069,849
Special Mention	926,975
Substandard	2,177,900
Total	$ 25,174,724

The following table shows an aging analysis of the loan portfolio by the time past due at December 31, 2011 and December 31, 2010:

December 31, 2011	30-89 Days Past Due	90 Days and Still Accruing	Nonaccrual	Total Past Due	Current	Total
Commercial real estate	$ -	$ -	$ 950,336	$ 950,336	$ 72,245,175	$ 73,195,511
Land and construction	148,807	-	2,901,677	3,050,484	9,257,909	12,308,393
Commercial and industrial	57,520	72,837	-	130,357	53,551,386	53,681,743
Agricultural land, real estate and production	-	-	-	-	11,154,197	11,154,197
Consumer	-	-	-	-	23,927,137	23,927,137
Total	$ 206,327	$ 72,837	$ 3,852,013	$ 4,131,177	$ 170,135,804	$ 174,266,981

December 31, 2010	30-89 Days Past Due	90 Days and Still Accruing	Nonaccrual	Total Past Due	Current	Total
Commercial real estate	$ 137,254	$ -	$ 131,085	$ 268,339	$ 63,819,889	$ 64,088,228
Land and construction	-	-	3,206,757	3,206,757	13,961,368	17,168,125
Commercial and industrial	-	-	-	-	45,466,874	45,466,874
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	$ 158,847,962	$ 163,096,212

Nonaccrual loans are reported at gross and includes $297,156 that is guaranteed by SBA. Interest foregone on nonaccrual loans was approximately $191,200 and $143,670 for the years ended December 31, 2011 and 2010, respectively.

The following table shows information related to impaired loans at and for the year ended December 31, 2011 and December 31, 2010:

Impaired Loans
For the Year ended December 31, 2011

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial real estate	$ 47,855	$ 108,061	$ -	$ 49,151	$ -
Commercial and industrial	297,157	410,522	-	166,936	-
Total	345,012	518,583	-	216,087	-
With an allowance recorded:					
Commercial real estate	605,325	605,325	137,932	151,331	-
Land and construction	3,725,098	3,725,098	388,197	3,107,533	-
Commercial and industrial	72,836	72,836	55,789	74,098	-
Total	4,403,259	4,403,259	581,918	3,332,962	-
Total:					
Commercial real estate	653,180	713,386	137,932	200,483	-
Land and construction	3,725,098	3,725,098	388,197	3,107,533	-
Commercial and industrial	369,993	483,358	55,789	241,034	-
Total	$ 4,748,271	$ 4,921,842	$ 581,918	$ 3,549,050	$ -

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	$ -

Troubled Debt Restructurings:

The Bank has not allocated specific reserves to customers whose loan terms have been modified in troubled debt restructurings as of December 31, 2011. The Bank has not committed to lend additional amounts as of December 31, 2011 to customers with outstanding loans that are classified as troubled debt restructurings.

During the year ending December 31, 2011, the terms of certain loans were modified as troubled debt restructurings. The modification of the terms of such loans included one or a combination of the following: a reduction of the stated interest rate of the loan; an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk; or a permanent reduction of the recorded investment in the loan.

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

The following table presents loans by class modified as troubled debt restructurings that occurred during the year ending December 31, 2011:

Modifications
As of December 31, 2011

	Number of Contracts	Pre-modification Outstanding Recorded Investments	Post-modification Outstanding Recorded Investments
Troubled Debt Restructuring			
Commercial	1	$ 921,287	$ 906,386
Troubled Debt Restructuring That Subsequently Defaulted			
Commercial	0	$ -	$ -

There were no troubled debt restructurings as of December 31, 2010.

NOTE 5. 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, 2011 and December 31, 2010:

	December 31, 2011	December 31, 2010
Leasehold improvements	$ 1,743,123	$ 1,843,918
Furniture, fixtures and equipment	1,604,028	1,595,935
Software and capitalized data & item processing	211,844	208,249
Computer equipment	564,625	503,452
Total premises and equipment	4,123,620	4,151,554
Less accumulated depreciation and amortization	(2,833,266)	(2,486,693)
Premises and equipment, net	$ 1,290,354	$ 1,664,861

Depreciation and amortization expense aggregated $446,000 for the year ended December 31, 2011 and $502,000 for the year ended December 31, 2010.

NOTE 6. DEPOSITS

Interest-bearing deposits consisted of the following:

	December 31, 2011	December 31, 2010
NOW accounts	$ 28,649,834	$ 25,240,662
Money Market	56,040,762	50,538,071
Time deposits $100,000 or more	55,462,427	51,323,785
Time deposits less than $100,000	20,818,546	22,150,110
Savings	14,220,663	9,836,763
	$ 175,192,232	$ 159,089,391

At December 31, 2011 the scheduled maturities for all time deposits were as follows:

	December 31, 2011
Three months or less	$ 34,040,686
Over three months through six months	20,291,005
Over six months through one year	19,853,029
Over one year through two years	1,178,369
Over two years	917,884
	$ 76,280,973

As of December 31, 2011 and 2010, the Bank had brokered deposits totaling $1,645,000 and $1,522,000, respectively. Interest expense on time deposits of $100,000 or more was $223,866 and $405,675 in 2011 and 2010, respectively.

NOTE 7. BORROWED FUNDS

At December 31, 2011 and December 31, 2010, the Bank had federal funds borrowing guidance lines with its correspondent banks in an aggregate amount of $12.0 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, 2011, the Bank had $62,030,581 in borrowing capacity available through the FHLB under which overnight and term advances were available. These advances are secured by assets including the Bank's ownership interest in the capital stock of the FHLB, securities and loans. The amounts pledged at December 31, 2011 included investment securities totaling $11,727,274 and loans totaling approximately $50,303,307. The amounts pledged at December 31, 2010 included investment securities totaling $4,199,878 and loans totaling approximately $36,719,000. The Bank recognized approximately one thousand dollars of interest expense in 2011 and 2010, respectively. The Bank had $2,000,000 of overnight borrowed funds outstanding at December 31, 2011 under these arrangements maturing on January 3, 2012 at a variable rate of 0.05% and none outstanding at December 31, 2010.

The transfer of SBA loans in 2010 did not meet the conditions for sale treatment due to the participating interest in a partial transfer of a financial asset and therefore the Bank was required to account for the transfer as a secured borrowing with pledge of collateral during 2010 as set forth in FASB Accounting Standards Update ("ASU") 2009-16. The Bank had $3,787,375 of borrowed funds outstanding 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, 2011 and 2010 are as follows:

	2011	2010
Allowance for loan losses	$ 1,491,126	$ 1,218,043
Deferred compensation	758,806	673,231
Accruals	295,529	239,373
Current state income tax	166,916	148,898
Other deferred tax assets	216,745	158,827
Gross deferred tax assets	2,929,122	2,438,372
Deferred loan costs	(380,415)	(229,440)
Fixed assets	(93,708)	(110,376)
Unrealized gain/loss and pension	(171,020)	(34,947)
Other deferred tax liabilities	(58,705)	(52,453)
Gross deferred tax liabilities	(703,848)	(427,216)
Net deferred tax asset	$ 2,225,274	$ 2,011,156

Management believes that it is more likely than not that the deferred tax assets will be realized as a result of expected continued profitability. Accordingly, no valuation allowance has been established as of December 31, 2011 or December 31, 2010.

The provision for income taxes is as follows for the years ended December 31, 2011 and 2010:

	2011	2010
Current:		
Federal	$ 1,970,872	$ 1,336,283
State	(114,905)	360,446
Total current	1,855,967	1,696,729
Deferred:		
Federal	$ (272,845)	$ (432,177)
State	(77,346)	(90,926)
Total deferred	(350,191)	(523,103)
Total provision	$ 1,505,776	$ 1,173,626

The effective tax rate differs from the federal statutory rate as follows for the years ended December 31, 2011 and 2010:

	Year ended December 31, 2011	2010
Federal statutory rate	34.00%	34.00%
State income tax, net of federal effect	5.96%	5.94%
Stock based compensation	0.56%	0.33%
Bank owned life insurance	(1.46%)	(1.56%)
Split dollar expense	0.54%	0.86%
Other	(1.33%)	(0.40%)
Net	38.27%	39.17%

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 2008 to 2011 and 2007 to 2011, respectively, are currently open for examination.

NOTE 9. EMPLOYEE BENEFIT PLANS

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. Total expense recognized during the year ending December 31, 2011 and December 31, 2010 was $62,920 and $75,511, respectively.

NOTE 10. STOCK BASED COMPENSATION

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

The following is a summary of the activity relating to the Bank's stock option plan for the year ended December 31, 2011 as presented below:

	December 31, 2011			
	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value
Options outstanding at beginning of year	281,390	$12.23		
Granted	8,500	$11.06		
Exercised	-	$0.00		
Forfeited or expired	(3,800)	$10.00		
Options outstanding at end of year	286,090	$12.22	3.09 years	$390,802
Options fully vested and expected to vest	247,090	$12.22	3.09 years	$390,802
Options exercisable	273,702	$12.18	2.84 years	$385,267

The following is a summary of the activity relating to the Bank's restricted stock award plan as of December 31, 2011 as presented below:

	December 31, 2011			
	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value
Awards outstanding at beginning of year	-	$0.00		
Granted	14,000	$11.15		
Expired	-	$0.00		
Awards granted and outstanding at end of year	14,000	$11.15	3.36 years	$165,200

The number and weighted average grant date fair value of options granted is as follows for the year ended December 31, 2011. There were no options granted in 2010:

	Number	Weighted Average Grant Date Fair Value
2011	8,500	$5.22

There were no options exercised during 2011 or 2010.

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 2011 are as follows:

	2011
Expected life (yrs.)	6.25
Volatility	45.38%
Risk free rate of return	0.90% - 1.93%
Dividend yield	0.00%

As of December 31, 2011 there was $60,802 and $130,125 of total unrecognized compensation cost related to nonvested stock options and nonvested restricted stock, respectively.

NOTE 11. RELATED PARTY TRANSACTIONS

In the ordinary course of business, the Bank makes loans to directors, officers, shareholders and their associates. At December 31, 2011 and 2010, 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 $2,254,631 and $2,511,178 at December 31, 2011 and December 31, 2010, respectively. Loan related activity to directors, officers and principal shareholders and their associates for the years ended December 31, 2011 and 2010 is as follows:

	2011	2010
Balance at beginning of year	$ 1,283,709	$ 167,621
New loans or disbursements	965,614	1,292,685
Principal repayments	(1,105,196)	(176,597)
Balance at end of year	$ 1,144,127	$ 1,283,709

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, 2011 and 2010.

	Year ended December 31, 2011	2010
Change in benefit obligation		
Benefit obligation at the beginning of the year	$ 1,791,888	$ 1,433,021
Service cost	100,247	158,662
Interest cost	99,210	90,583
Actuarial (losses) gains	(12,294)	140,210
Expected benefits paid	(37,471)	(30,588)
Projected benefit obligation at the end of the year	1,941,580	1,791,888
Funded status	(1,941,580)	(1,791,888)
Unrecognized net actuarial gain	127,426	139,720
Unrecognized prior service cost	38,410	46,890
(Accrued)/ prepaid benefit cost	(1,775,744)	(1,605,278)
Accrued Benefit Liability	(1,941,580)	(1,791,888)
Accumulated Other Comprehensive Expense	165,836	186,610
Net Amount Recognized	$ (1,775,744)	$ (1,605,278)
Weighted average assumptions to determine benefit obligation as of December 31:		
Discount rate	5.30%	5.30%
Rate of compensation increase	N/A	N/A

The components of net periodic benefit cost recognized for the years ended December 31, 2011 and 2010 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, 2012 are as follows:

	Year ended December 31, 2012	2011	2010
Components of net periodic benefit cost	(forecast)		
Service cost	$ 101,260	$ 100,247	$ 116,240
Interest Cost	107,184	99,210	90,583
Amortization of prior service cost	8,480	8,480	8,480
Net periodic benefit cost	$ 216,924	$ 207,937	$ 215,303

NOTE 13. RESTRICTIONS, COMMITMENTS, CONTINGENCIES AND OTHER DISCLOSURES

Restrictions on Cash and Due from Banks: Santa Cruz County Bank is subject to Federal Reserve Act Regulation D, which requires banks to maintain average reserve balances with the Federal Reserve Bank. Reserve requirements are offset by usable cash reserves. The Bank had no reserve requirement at December 31, 2011 and December 31, 2010.

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,	
2012	$ 543,000
2013	493,000
2014	370,000
2015	332,000
2016	335,000
Thereafter	375,000
	$ 2,448,000

Building and kiosk rent expense for the year ended December 31, 2011 and December 31, 2010, was approximately $564,000 and $566,000, 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 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, 2011 and December 31, 2010 are as follows:

	December 31,	
	2011	2010
Commitments to extend credit	$ 70,323,186	$ 48,078,422
Standby letters of credit	1,894,601	2,899,655
	$ 72,217,787	$ 50,978,077

Legal Matters: The Bank is subject to certain legal proceedings arising in the normal course of business. At December 31, 2011, the Bank was not subject to any claims and/or lawsuits.

SANTA CRUZ COUNTY BANK

NOTES TO FINANCIAL STATEMENTS

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 Income as of December 31:

	December 31, 2011	December 31, 2010
Other non-interest income:		
BOLI non-interest income	$ 168,780	$ 137,713
Merchant Processing Fees	203,020	208,771
SBA Servicing and Packaging Fees	281,798	207,083
ATM Fee Income	362,061	281,060
Other non-interest income	48,572	72,255
Total other non-interest income	$ 1,064,231	$ 906,882
Other non-interest expense:		
Stationery, supplies and printing	$ 104,955	$ 125,546
Armored car and messenger	80,013	82,333
Telephone, postage and electronic communication	147,646	144,629
Correspondent bank charges	169,981	186,993
Insurance and security	81,602	76,373
Loan and collection expense	264,681	245,307
ATM related expenses	194,258	164,217
Shareholder related expense	114,368	100,538
Other non-interest expenses	717,666	419,559
Total other non-interest expenses	$ 1,875,170	$ 1,545,495

NOTE 15. REGULATORY CAPITAL REQUIREMENTS AND OTHER REGULATORY MATTERS

Dividend Restrictions: The Board of Directors may, to the extent of such earnings and the Bank's net capital requirements and subject to the provisions of the California Financial Code, declare and pay a portion of such earnings to its shareholders as dividends. 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, 2011 and 2010, 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, 2011, this ratio was 8.31%.

(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, 2011						
Total capital (to risk weighted assets)	$ 29,121	13.39%	$ 17,398	8.00%	$ 21,748	10.00%
Tier 1 capital (to risk weighted assets)	$ 26,382	12.13%	$ 8,699	4.00%	$ 13,049	6.00%
Tier 1 capital (to average assets) leverage ratio	$ 26,382	8.31%	$ 12,701	4.00%	$ 15,876	5.00%
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	8.31%	$ 11,501	4.00%	$ 14,376	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

The following table presents the carrying amounts and estimated fair values of the Bank's financial instruments at December 31, 2011 and December 31, 2010. The fair value of financial instruments does not represent actual amounts that may be realized upon any sale or liquidation of the related assets or liabilities. In addition, these values do not give effect to discounts to fair value which may occur when financial instruments are sold in larger quantities. The fair values presented represent the Bank's best estimate of fair value using the methodologies discussed below.

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

	December 31, 2011		2010	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial Assets:				
Cash and cash equivalents	$ 8,597,352	$ 8,597,352	$ 13,309,904	$ 13,309,904
Certificates of deposit	64,232,000	65,214,000	54,069,000	55,189,000
Securities available-for-sale	44,840,223	44,840,223	25,791,005	25,791,005
Securities held-to-maturity	297,210	313,763	451,765	470,665
Loans held for sale	17,102,575	17,845,071	18,354,576	19,518,251
Loans, net	170,043,808	178,058,000	159,477,028	179,924,000
Bankers' Bank stock, at cost	1,100,100	N/A	1,026,200	N/A
Accrued interest receivable	1,003,634	1,003,634	830,540	830,540
Financial Liabilities:				
Noninterest-bearing demand deposits	$ 113,014,682	$ 113,014,682	$ 94,326,653	$ 94,326,653
Interest-bearing demand deposits	28,649,834	28,592,000	25,240,662	25,240,662
Savings and money market deposits	70,261,425	70,213,000	60,374,834	60,374,834
Time certificates of deposit	76,280,973	76,286,000	73,473,895	73,489,000
Accrued interest payable	114,419	114,419	182,952	182,952
Other borrowings	2,000,000	2,000,000	3,787,375	3,787,375

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, 2011 and December 31, 2010 approximate their current book values.

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

Accrued Interest Receivable: 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: 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, 2011 and 2010:

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

Recurring Basis

	2011			
	Fair Value	Level 1	Level 2	Level 3
Securities available for sale:				
U.S. government sponsored agencies	$ 2,103,850	$ -	$ 2,103,850	$ -
U.S. government sponsored MBS's	27,740,124	-	27,740,124	-
Municipal	14,270,809	-	14,270,809	-
Corporate	725,440	-	725,440	-
Total assets measured at Fair Value	$ 44,840,223	$ -	$ 44,840,223	$ -

	2010			
	Fair Value	Level 1	Level 2	Level 3
Securities available for sale:				
U.S. government sponsored agencies	$ 3,933,660	$ -	$ 3,933,660	$ -
U.S. government sponsored 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	$ -

Fair values for available-for-sale investment securities are based on quoted market prices for similar securities. During the year ended December 31, 2011, 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 2011.

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:

Non-recurring Basis

	December 31, 2011			
	Fair Value	Level 1	Level 2	Level 3
Impaired loans:				
Land and construction	$ 3,336,901	$ -	$ -	$ 3,336,901
Commercial real estate	467,393	-	-	467,393
Commercial and industrial	17,047	-	-	17,047
Real estate owned:				
Land and construction	2,724,445	-	-	2,724,445
Commercial real estate	207,444	-	-	207,444
Total assets measured at Fair Value	$ 6,753,230	$ -	$ -	$ 6,753,230

	December 31, 2010			
	Fair Value	Level 1	Level 2	Level 3
Impaired loans:				
Land and construction	$ 3,024,256	$ -	$ -	$ 3,024,256
Commercial real estate	57,536	-	-	57,536
Commercial and industrial	38,467	-	-	38,467
Real estate owned:				
Commercial real estate	1,358,403	-	-	1,358,403
Total assets measured at Fair Value	$ 4,478,662	$ -	$ -	$ 4,478,662

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

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

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.

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 and Robert & Bjorg Yonts. *denotes Bank Directors

The 2011 Board pictured at the historic Rodgers House in Watsonville from top to bottom and left to right: David V. Heald, William J. Hansen (Vice-Chairman), Thomas N. Griffin, Steven G. John, Gary A. Reece, George R. Gallucci (Chairman), Tila Guerrero, and Kenneth R. Chappell.

2012 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
Harvey J. Nickelson, Retired Bank CEO and Community Volunteer
Gary A. Reece, President, The Development Group

SANTA CRUZ COUNTY BANK MANAGEMENT TEAM

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
Jaime Manriquez, Senior Vice President, Chief Technology Officer and Information Security Officer
Heather LaFontaine, Vice President, Risk Management Officer and Human Resources Manager
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

BANKING LOCATIONS:

APTOS
7775 Soquel Drive
662.6000

CAPITOLA
819 Bay Avenue
464.5300

SANTA CRUZ
720 Front Street
457.5000

SCOTTS VALLEY
4604 Scotts Valley Drive
461.5000

WATSONVILLE
595 Auto Center Drive
761.7600

ATM & NIGHT DEPOSITORY LOCATIONS:

Dominican Hospital Campus
1555 Soquel Drive, Santa Cruz

Deluxe Foods
783-25 Rio Del Mar Boulevard, Aptos

sccountybank.com

MEMBER FDIC

Preferred SBA Lender

EQUAL HOUSING LENDER

FSC