California Oaks State Bank

The Business of Building Success

2007 Annual Report

California Oaks State Bank

www.caloaks.com

Equal Housing Lender

SBA Preferred Lender

To Our Shareholders and Customers:

As I think back on 2007 and all of the changes that have occurred at California Oaks State Bank, it is true of the saying, "the only thing constant is change." In April, the previous CEO, Cole Minnick, resigned from the Bank to pursue other interests. Cole had previously presided over the clean-up of the Bank from the previous challenges of a defalcation and lack of internal controls. I was fortunate enough to be hired as the Bank's CEO in August of this year after 21 years in banking in Northern California.

Over the past year, the banking industry has been challenged with many different issues that have taken center stage in the national economy. The most significant challenge in the big picture was the implosion of the sub-prime lending market. With the sub-prime crash, the entire mortgage market basically came to a screeching halt. Although community banks have traditionally not participated in the sub-prime lending market or the mortgage market, there has been a trickle down effect on all banks. For the record, California Oaks does not participate in the sub-prime lending market.

Overall, in the third and fourth quarters of 2007 the banking world has delivered record loan loss provisions. Banks have had to reevaluate their current loan portfolios and take a serious look at the current stresses they exhibit. These stresses have also found their way into California Oaks State Bank. The loan losses the Bank has recorded are limited to a few borrowers who could not withstand the challenges in the current economy.

In coming to California Oaks State Bank, I met with the management team to set out the direction we felt would deliver the best results for the Bank in the long run. This process was vetted out with good discussion prior to being presented for approval by the Board of Directors at the annual strategic planning meeting. A number of changes would need to be made at the Bank if we wanted to become a high performing Bank in the next two years.

One of the first changes to be made was the separation of the sales and the credit function. This is in line with industry best practices. Next was the implementation of an overall sales culture. Although a culture is not created overnight, the sales process is something that can be measured and inspected. A cash management group was recently formed to support the sales team in gathering core deposits. The cash management group is in charge of the existing bank products such as our "Digital Deposit℠" remote capture product, our merchant services product and our most recent addition, positive pay fraud detection. These products will help the Bank expand its core deposit totals, which in turn will ensure our cost of funds remain one of the lowest in the state of California.

We also determined that the Bank was very asset sensitive. As rates drop, so would the Bank's income. The alternatives presented were to buy derivatives that we did not totally understand or look to book longer term assets with fixed rates. We have chosen the latter. Unfortunately, the rate cuts have been quicker than expected, which will slow the building of our income base.

In performing our risk assessment of the Bank, one of the largest risks the Bank faced was the accounts receivable finance business, better known as a factoring department. I have found the risks associated with this type of lending to be too great for our business model, and thus we are currently exiting this field. The rewards over the past years have been great from this line of business; unfortunately so have the risks.

We also reviewed our non-interest expenses and determined that we were running at a much more expensive model compared to our peer group. This included reviewing the existing staffing levels and determining that cutting staff from 44 employees to 36 employees would help in our general key efficiencies. Unfortunately, you can never cut your way to prosperity. With the fixed overhead that the Bank has, we have determined that the Bank also needs to grow its loans and deposits in a significant manner. Growth along with cost containment will bring the Bank into an enviable position over time.

Our target client continues to be local businesses, professionals and non-profit organizations. As was mentioned in the third quarter report, we have entered the Northern California market in the dental lending field. In the fourth quarter we also started a dental lending program in Southern California. This will leverage the existing infrastructure to exploit an area we feel we have a competitive advantage over our competition.

One of the unique services that community banks offer their clients is a high level of client service. California Oaks is no different than our competitors in this area. Thus, in an effort to take our service levels up a notch, we have hired the Ritz Carlton to provide the Bank with a "Back to Basics" training program. We feel this will help us differentiate ourselves from our competition and keep our existing client base loyal to the Bank.

Let me close with a request for our shareholders: I believe we have made significant changes to our operating model over the past six months since my arrival at the Bank. The franchise value to the Bank is in the core deposits that we currently maintain. The reality is we need more core deposits to take us to the next level of our success. Please consider moving your deposits over to the Bank or bringing additional deposits over from your other banking institutions.

Thank you for supporting your Bank.

ROBERT E. LEWIS
Chairman of the Board

Robert E. Lewis

JOHN A. NERLAND
President & Chief Executive Officer

John A. Nerland

DIRECTORS

Robert E. Lewis
Chairman of the Board
Managing Partner
Ablon, Lewis, Bass & Gale

Robert J. Brown
President
The Comdyn Group

Michael L. Iverson
Owner
Iverson Construction, Inc.

Robert P. Keller
Managing Director
Triumph Investment

Leonard M. Linton
Chief Executive Officer
1st Nationwide Resources Group

L. Karsten Lundring
Managing Partner
Thrivent Financial for Lutherans

John A. Nerland
President & Chief Executive Officer
California Oaks State Bank

Norman J. Nagel, D.D.S
Orthodontist

OFFICERS

EXECUTIVE OFFICERS

John A. Nerland
President
Chief Executive Officer

Kenneth S. Paris
Executive Vice President
Chief Credit Officer

Jerry D. Smith
Executive Vice President
Chief Financial Officer

THOUSAND OAKS OFFICE

Lynn Kistner
Senior Vice President
Human Resources Director

John Gallarza
Vice President
Senior Business Loan Underwriter

Catherine Giuffre-Ornelas
Vice President
Branch Operations Manager

Priscilla Jewell
Vice President
Compliance Officer

Tom Odegard
Vice President
Business Loan Underwriter

Muoysim Tang-Paradis
Vice President
Financial Sales Officer

Dianna Traylor
Vice President
Controller

Nicole Andrews
Assistant Vice President
Operations Officer

Elizabeth De Alejandro
Assistant Vice President
Account Services Manager

Nancy Jones
Assistant Vice President
Loan Administrative Assistant

Jean Lauder
Assistant Vice President
Loan Servicing Manager

Daniel Quick
Assistant Vice President
Financial Systems Officer

Jeff Yriarte
Assistant Vice President
Financial Sales Officer

SIMI VALLEY OFFICE

Alan Kravets
Vice President
Financial Sales Officer

Amber Sorbello
Assistant Vice President
Operations Manager

Kelly Ankenman
Operations Officer

WALNUT CREEK OFFICE

Jamie Smith
Senior Vice President
Financial Sales Manager

Amy Maguddatu
Vice President
Professional Services Officer

CALIFORNIA OAKS STATE BANK

FINANCIAL STATEMENTS
WITH
INDEPENDENT AUDITORS' REPORT

December 31, 2007 and 2006

Vavrinek, Trine, Day & Co., LLP
Certified Public Accountants & Consultants

VALUE THE DIFFERENCE

INDEPENDENT AUDITORS' REPORT

Board of Directors and Shareholders of
California Oaks State Bank

We have audited the accompanying balance sheets of California Oaks State Bank as of December 31, 2007 and 2006, and the related statements of income, changes in shareholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of California Oaks State Bank as of December 31, 2007 and 2006 and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Vavrinek, Trine, Day & Co., LLP

Laguna Hills, California
February 12, 2008

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CALIFORNIA OAKS STATE BANK

BALANCE SHEETS
December 31, 2007 and 2006

	2007	2006
ASSETS		
Cash and Due from Banks	$ 4,733,453	$ 8,319,131
Federal Funds Sold	5,775,000	6,420,000
TOTAL CASH AND CASH EQUIVALENTS	10,508,453	14,739,131
Time Deposits in Other Financial Institutions	100,000	-
Investment Securities Available for Sale	6,076,730	7,938,593
Loans:		
Construction	14,846,887	19,419,458
Commercial Real Estate	28,067,016	30,426,091
Residential Real Estate	6,441,597	11,828,163
Commercial	34,280,188	21,625,373
Accounts Receivable Financing	2,256,471	5,059,019
Consumer	1,934,004	1,447,436
TOTAL LOANS	87,826,163	89,805,540
Net Deferred Loan Fees	(166,424)	(121,214)
Allowance for Loan Losses	(982,413)	(1,042,417)
NET LOANS	86,677,326	88,641,909
Accrued Interest Receivable	428,389	403,115
Premises and Equipment	471,593	346,036
Federal Home Loan Bank Stock - at Cost	658,000	381,300
Net Deferred Tax Assets	602,000	765,000
Other Assets	999,839	844,637
	$ 106,522,330	$ 114,059,721

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

CALIFORNIA OAKS STATE BANK

BALANCE SHEETS
December 31, 2007 and 2006

	2007	2006
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Noninterest-Bearing Demand	$ 34,154,673	$ 39,148,869
Money Market and NOW Accounts	26,391,527	26,297,187
Savings	4,056,319	4,662,485
Time Deposits Under $100,000	3,056,323	7,757,577
Time Deposits $100,000 and Over	9,169,994	13,382,249
TOTAL DEPOSITS	76,828,836	91,248,367
Federal Home Loan Bank Advances	14,000,000	8,002,900
Accrued Interest and Other Liabilities	608,684	636,110
TOTAL LIABILITIES	91,437,520	99,887,377
Commitments and Contingencies - Notes 4 and 10	-	-
Shareholders' Equity:		
Serial Preferred Stock - 10,000,000 Shares Authorized, No Par Value, no Shares Issued and Outstanding		
Common Stock - 10,000,000 Shares Authorized; Shares Issued and Outstanding - 1,477,587 in 2007 and 1,446,537 in 2006	14,697,981	14,295,587
Additional Paid-in Capital	247,944	82,023
Retained Earnings (Deficit)	156,719	(105,763)
Accumulated Other Comprehensive Loss - Net Unrealized Loss on Investment Securities Classified as Available for Sale, Net of Taxes of $12,393 in 2007 and $69,146 in 2006	(17,834)	(99,503)
TOTAL SHAREHOLDERS' EQUITY	15,084,810	14,172,344
	$ 106,522,330	$ 114,059,721

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

CALIFORNIA OAKS STATE BANK

STATEMENTS OF INCOME
For the Years Ended December 31, 2007 and 2006

	2007	2006
INTEREST INCOME		
Interest and Fees on Loans	$ 8,131,414	$ 7,961,964
Interest on Investment Securities	306,626	247,381
Interest on Federal Funds	335,555	355,484
Other Interest Income	30,561	16,194
TOTAL INTEREST INCOME	8,804,156	8,581,023
INTEREST EXPENSE		
Interest on Money Market, Savings and NOW Accounts	462,021	355,314
Interest on Time Deposits	902,699	675,482
Other Borrowings	237,261	276,174
TOTAL INTEREST EXPENSE	1,601,981	1,306,970
NET INTEREST INCOME	7,202,175	7,274,053
Provision for Loan Losses	663,678	170,000
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	6,538,497	7,104,053
NONINTEREST INCOME		
Service Charges, Fees and Other Income	721,505	633,009
Gain on Sale of SBA Loans	204,599	78,755
	926,104	711,764
NONINTEREST EXPENSE		
Salaries and Employee Benefits	3,760,404	3,232,099
Occupancy Expenses	757,840	742,376
Furniture and Equipment	225,119	206,648
Data Processing Expense	563,316	538,558
Advertising and Marketing Expense	209,019	219,649
Professional Services	371,094	350,267
Messenger and Courier Services	104,346	115,242
Insurance and Assessments	153,373	130,475
Other Expenses	808,958	854,464
	6,953,469	6,389,778
INCOME BEFORE INCOME TAXES	511,132	1,426,039
Income Taxes (Benefit)	248,650	(192,985)
NET INCOME	$ 262,482	$ 1,619,024
NET INCOME PER SHARE - BASIC	$ 0.18	$ 1.12
NET INCOME PER SHARE - DILUTED	$ 0.17	$ 1.08

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

CALIFORNIA OAKS STATE BANK

STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
For the Years Ended December 31, 2007 and 2006

	Comprehensive Income	Common Stock Number of Shares	Common Stock Amount	Additional Paid-in Capital	Retained Earnings (Deficit)	Accumulated Other Comprehensive Income (Loss)	Total
Balance at January 1, 2006		1,438,943	$ 14,207,573	$ -	$(1,724,787)	$(244,336)	$ 12,238,450
Proceeds from Exercise of Stock Options		7,594	88,014				88,014
Stock-Based Compensation				82,023			82,023
Comprehensive Income:							
Net Income	$ 1,619,024				1,619,024		1,619,024
Unrealized Gains on Available-for-Sale Securities Net of Taxes of $69,146	144,833					144,833	144,833
Total Comprehensive Income	$ 1,763,857						
Balance at December 31, 2006		1,446,537	14,295,587	82,023	(105,763)	(99,503)	14,172,344
Proceeds from Exercise of Stock Options, including $59,293 of Related Tax Benefits		31,050	402,394				402,394
Stock-Based Compensation				165,921			165,921
Comprehensive Income:							
Net Income	$ 262,482				262,482		262,482
Unrealized Gains on Available-for-Sale Securities Net of Taxes of $56,753	81,669					81,669	81,669
Total Comprehensive Income	$ 344,151						
Balance at December 31, 2007		1,477,587	$ 14,697,981	$ 247,944	$ 156,719	$(17,834)	$ 15,084,810

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

CALIFORNIA OAKS STATE BANK

STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2007 and 2006

	2007	2006
OPERATING ACTIVITIES		
Net Income	$ 262,482	$ 1,619,024
Adjustments to Reconcile Net Income to Net		
Cash Provided by Operating Activities:		
Depreciation and Amortization	235,461	261,706
Provision for Loan Losses	663,678	170,000
Gain on Sale of SBA Loans	(204,599)	(78,755)
Stock-based Compensation	165,921	82,023
Deferred Taxes	106,000	(193,785)
Other Items - Net	(41,231)	(73,187)
NET CASH PROVIDED BY OPERATING ACTIVITIES	1,187,712	1,787,026
INVESTING ACTIVITIES		
Increase in Deposits in Other Financial Institutions	(100,000)	-
Purchases of Available-for-Sale Securities	(102,486)	(2,000,000)
Proceeds from Maturities of Available-for-Sale Securities	2,074,030	1,229,892
Net Increase in Loans	(2,108,681)	(14,703,481)
Proceeds from Sale of SBA Loans	3,447,761	1,349,984
Net Change in Federal Home Loan Bank Stock	(276,700)	(16,300)
Purchases of Premises and Equipment	(332,277)	(103,916)
NET CASH PROVIDED (USED) BY INVESTING ACTIVITIES	2,601,647	(14,243,821)
FINANCING ACTIVITIES		
Net Change in Demand Deposits and Savings Accounts	(5,506,022)	166,762
Net Change in Time Deposits	(8,913,509)	7,335,180
Net Increase in Federal Home Loan Bank Advances	5,997,100	8,002,900
Proceeds from Exercise of Options	402,394	88,014
NET CASH PROVIDED (USED) BY FINANCING ACTIVITIES	(8,020,037)	15,592,856
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(4,230,678)	3,136,061
Cash and Cash Equivalents at Beginning of Period	14,739,131	11,603,070
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 10,508,453	$ 14,739,131
Supplemental Disclosures of Cash Flow Information:		
Interest Paid	$ 1,622,671	$ 1,251,729
Taxes Paid	$ 307,433	$ 7,015

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

CALIFORNIA OAKS STATE BANK

NOTES TO FINANCIAL STATEMENTS
December 31, 2007 and 2006

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

<u>Nature of Operations</u>

California Oaks State Bank (the "Bank") generates commercial and consumer loans and receives deposits from customers located primarily in the Conejo Valley area of Ventura County, California. The Bank was formed in 1997 and commenced operations in 1998. The Bank has two branches, one in Thousand Oaks and one in Simi Valley. The financial information for the branches has been aggregated into one reporting segment. The Bank operates under a state charter and provides full banking services. As a state bank, the Bank is subject to regulation by the California Department of Financial Institutions ("DFI") and the Federal Deposit Insurance Corporation ("FDIC"). The accounting and reporting policies of the Bank are in accordance with accounting principles generally accepted in the United States of America and conform to practices within the banking industry. The following are descriptions of the more significant of those polices.

<u>Use of Estimates in the Preparation of Financial Statements</u>

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, 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 determination of the adequacy of the allowance for loan losses is based on estimates that are particularly susceptible to significant changes in the economic environment and market conditions. In connection with the determination of the estimated losses on loans, management obtains independent appraisals for significant collateral. The Bank's loans are generally secured by specific items of collateral including real property, consumer assets and business assets.

While management uses available information to recognize losses on loans, further reductions in the carrying amounts of loans may be necessary based on changes in local economic conditions. Because of these factors, it is reasonably possible that the estimated losses on loans may change materially in the near term. However, the amount of the changes that is reasonably possible cannot be estimated.

<u>Cash and Cash Equivalents</u>

For purposes of reporting cash flows, cash and cash equivalents include cash, due from banks and federal funds sold. Generally, federal funds are sold for one-day periods.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Cash and Due from Banks

Banking regulations require that banks maintain a percentage of their deposits as reserves in cash or on deposit with the Federal Reserve Bank. The Bank complied with the reserve requirements as of December 31, 2007.

The Bank maintains amounts due from banks, which exceed federally insured limits. The Bank has not experienced any losses in such accounts.

Investment Securities

Investments not classified as trading securities nor as held to maturity securities are classified as available-for-sale securities and recorded at fair value. Unrealized gains or losses on available-for-sale securities are excluded from net income and reported as an amount net of taxes as a separate component of other comprehensive income included in shareholders' equity. Premiums or discounts on held-to-maturity and available-for-sale securities are amortized or accreted into income using the interest method. Realized gains or losses on sales of held-to-maturity or available-for-sale securities are recorded using the specific identification method.

Declines in the fair value of individual available-for-sale securities below their cost that are other-than-temporary result in write-downs of the individual securities to their fair value. The related write-downs are included in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers the length of time and the extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer, and the intent and ability of the Bank to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

Loans

Loans are reported at the principal amount outstanding, net of any deferred loan origination fee income and deferred direct loan origination costs, and net of any unearned interest on discounted loans. Deferred loan origination fee income and direct loan origination costs are amortized to interest income over the life of the loan using the interest method. Interest on loans is accrued to income daily based upon the outstanding principal balances.

Loans for which the accrual of interest has been discontinued are designated as nonaccrual loans. Accrual of interest on such loans is discontinued when there exists a reasonable doubt as to the full and timely collection of either principal or interest or when principal or interest is past due 90 days, based on the contractual terms of the loan. Income on such loans is then only recognized to the extent that cash is received and where the future collection of principal is probable. Accrual of interest is resumed only when principal and interest are brought fully current and when such loans are considered to be collectible as to both principal and interest.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Loans - Continued

For impairment recognized in accordance with Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Standards ("SFAS") No. 114, *"Accounting by Creditors for Impairment of a Loan"*, as amended by SFAS No. 118, the entire change in the present value of expected cash flows is reported as either provision for loan losses in the same manner in which impairment initially was recognized, or as a reduction in the amount of provision for loan losses that otherwise would be reported.

To calculate the gain (loss) on sale of loans, the Bank's investment in the loan is allocated among the retained portion of the loan, the servicing retained the interest-only strip and the sold portion of the loan, based on the relative fair market value of each portion. The gain (loss) on the sold portion of the loan is recognized at the time of sale based on the difference between the sale proceeds and the allocated investment. As a result of the relative fair value allocation, the carrying value of the retained portion is discounted, with the discount accreted to interest income over the life of the loan. That portion of the excess servicing fees that represent contractually specified servicing fees (contractual servicing) are reflected as a servicing asset which is amortized over an estimated life using a method approximating the level yield method; in the event future prepayments exceed Management's estimates and future expected cash flows are inadequate to cover the unamortized servicing asset, additional amortization would be recognized. The portion of excess servicing fees in excess of the contractual servicing fees is reflected as interest-only (I/O) strips receivable, which are classified as interest-only strips receivable available for sale and are carried at fair value.

Allowance for Loan Losses

The allowance for loan losses is adjusted by charges to income and decreased by charge-offs (net of recoveries). Management's periodic evaluation of the adequacy of the allowance is based on the Bank's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, and current economic conditions.

Premises and Equipment

Premises and equipment are carried at cost less accumulated depreciation and amortization. Depreciation is computed using the straight-line method over the estimated useful lives, which ranges from three to ten years for furniture, fixtures and equipment. Leasehold improvements are amortized using the straight-line method over the estimated useful lives of the improvements or the remaining lease term, whichever is shorter. Expenditures for betterments or major repairs are capitalized and those for ordinary repairs and maintenance are charged to operations as incurred.

Advertising Costs

The Bank expenses the costs of advertising in the period incurred.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

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 consolidated financial statements. A valuation allowance is established to reduce the deferred tax asset to the level at which it is “more likely than not” that the tax asset or benefits will be realized. Realization of tax benefits of deductible temporary differences and operating loss carryforwards depends on having sufficient taxable income of an appropriate character within the carryforward periods. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

The Bank has adopted Financial Accounting Standards Interpretation No. 48 (“FIN 48”), *Accounting for Uncertainty in Income Taxes*. FIN 48 clarifies the accounting for uncertainty in tax positions taken or expected to be taken on a tax return and provides that the tax effects from an uncertain tax position can be recognized in the financial statements only if, based on its merits, the position is more likely than not to be sustained on audit by the taxing authorities. Management believes that all tax positions taken to date are highly certain and, accordingly, no accounting adjustment has been made to the financial statements. Interest and penalties related to uncertain tax positions are recorded as part of income tax expense.

Comprehensive Income

The Bank adopted SFAS No. 130, *"Reporting Comprehensive Income,"* which requires the disclosure of comprehensive income and its components. Changes in unrealized gain (loss) on available-for-sale securities net of income taxes is the only component of accumulated other comprehensive income for the Bank.

Earnings Per Share (EPS)

Basic EPS excludes dilution and is computed by dividing income available to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if options or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity.

Financial Instruments

In the ordinary course of business, the Bank has entered into off-balance sheet financial instruments consisting of commitments to extend credit, commercial letters of credit, and standby letters of credit as described in Note 10. Such financial instruments are recorded in the financial statements when they are funded or related fees are incurred or received.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Disclosure about Fair Value of Financial Instruments

SFAS No. 107 specifies the disclosure of the estimated fair value of financial instruments. The Bank's estimated fair value amounts have been determined 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.

Stock-Based Compensation

The Bank has adopted SFAS No. 123 (R) "*Shared-Based Payment.*" This Statement generally requires entities to recognize the cost of employee services received in exchange for awards of stock options, or other equity instruments, based on the grant-date fair value of those awards. This cost is recognized over the period which an employee is required to provide services in exchange for the award, generally the vesting period.

Adoption of New Accounting Pronouncements

In March 2006, the FASB issued SFAS No. 156, *Accounting for Servicing of Financial Assets*, ("SFAS 156"), which amends SFAS No. 140. SFAS No. 156 changes SFAS No. 140 by requiring that servicing assets be initially recognized at their fair value and by providing the option to either: (1) carry servicing rights at fair value with changes in fair value recognized in current period earnings; or (2) continue recognizing periodic amortization expense and assess the servicing rights for impairment as originally required by SFAS No. 140. This option may be applied by class of servicing asset or liability. The Bank adopted SFAS No. 156 effective January 1, 2007. The Bank identified servicing assets in relating to all existing SBA loans as a class of serving rights and elected to apply the amortization method accounting to these servicing assets. Presently, this class represents all of the Bank's servicing assets. The application of SFAS No. 156 did not have a significant impact on the consolidated financial position or earnings of the Bank.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

New Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, "*Fair Value Measurements,*" effective for the Bank January 1, 2008. This Statement defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. This statement establishes a fair value hierarchy that distinguishes between valuations obtained from sources independent of the entity and those from the entity's own observable inputs that are not corroborated by observable market data. SFAS No. 157 expands disclosures about the use of fair value to measure assets and liabilities in interim and annual periods subsequent to initial recognition. The disclosures focus on the inputs used to measure fair value, and for recurring fair value measurements using significant unobservable inputs, the effect of the measurements on earnings or changes in net assets for the period. The Bank is currently assessing the impact of this guidance on its financial statements.

In February 2007, the FASB issued SFAS No. 159, "*The Fair Value Option for Financial Assets and Financial Liabilities – Including an Amendment of FASB Statement No. 115.*" SFAS No. 159 permits an entity to choose to measure many financial instruments and certain other items at fair value. Most of the provisions of SFAS No. 159 are elective; however, the amendment to SFAS 115, "*Accounting for Certain Investments in Debt and Equity Securities,*" applies to all entities with available-for-sale or trading securities. For financial instruments elected to be accounted for at fair value, an entity will report the unrealized gains and losses in earnings. SFAS No. 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. The Bank is currently assessing the financial impact this Statement will have on the statement of financial condition or results of operations.

Reclassifications

Certain reclassifications have been made in the 2006 financial statements to conform to the presentation used in 2007. These reclassifications had no impact on the Bank's previously reported financial statements.

NOTE 2 - INVESTMENT SECURITIES

Debt and equity securities have been classified in the statements of condition according to management's intent. The carrying amount of available-for-sale securities and their approximate fair values at December 31 were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2007				
U.S. Agency Securities	$ 2,999,235	$ 11,936	$(4,403)	$ 3,006,768
State and Municipal Securities	102,281	-	(1,085)	101,196
Mortgaged-Backed Securities	3,005,441	15	(36,690)	2,968,766
	$ 6,106,957	$ 11,951	$(42,178)	$ 6,076,730
December 31, 2006				
U.S. Agency Securities	$ 3,997,163	$ 1,106	$(43,483)	$ 3,954,786
Mortgaged-Backed Securities	4,110,079	-	(126,272)	3,983,807
	$ 8,107,242	$ 1,106	$(169,755)	$ 7,938,593

Securities carried at approximately $3,038,000 and $3,280,000 at December 31, 2007 and 2006, respectively, were pledged to secure deposits of public funds and borrowing arrangements.

The scheduled maturities of investment securities at December 31, 2007 were as follows:

	Available-for-Sale	
	Amortized Cost	Fair Value
Due After One Year through Five Years	$ 1,999,235	$ 2,005,054
After Five Years through Ten Years	1,102,281	1,102,910
Mortgaged-Backed Securities	3,005,441	2,968,766
	$ 6,106,957	$ 6,076,730

The Bank did not sell any of its available-for-sale securities in 2007 and 2006.

NOTE 2 - INVESTMENT SECURITIES - Continued

The unrealized losses in available-for-sale securities as of December 31, 2007 and 2006 with continuous losses present for less than twelve months and twelve months or more and their fair value is summarized below:

	Less than Twelve Months		Twelve Months or More		Total	
	Losses	Fair Value	Losses	Fair Value	Losses	Fair Value
December 31, 2007						
U.S. Agency Securities	$ -	$ -	$(4,403)	$ 994,832	$(4,403)	$ 994,832
State and Municipal Securities	(1,085)	101,196	-	-	(1,085)	101,196
Mortgaged-Backed Securities	-	-	(36,690)	2,945,466	(36,690)	2,945,466
	$(1,085)	$ 101,196	$(41,093)	$ 3,940,298	$(42,178)	$ 4,041,494
December 31, 2006						
U.S. Agency Securities	$(1,475)	$ 998,525	$(42,008)	$ 1,955,155	$(43,483)	$ 2,953,680
Mortgaged-Backed Securities	-	-	(126,272)	3,983,807	(126,272)	3,983,807
	$(1,475)	$ 998,525	$(168,280)	$ 5,938,962	$(169,755)	$ 6,937,487

As of December 31, 2007, the Bank had sixteen investment securities whose estimated fair value had declined 1.0% from the Bank's amortized cost. Management evaluates investment securities for other-than-temporary impairment taking into consideration the extent and length of time the fair value has been less than cost, the financial condition of the issuer and whether the Bank has the intent and ability to retain the investment for a period of time sufficient to allow for any anticipated recovery in fair value. As of December 31, 2007, no declines in value are deemed to be other-than-temporary.

NOTE 3 - LOANS

Although the Bank seeks to avoid concentrations of loans to a single industry or based upon a single class of collateral, real estate and real estate associated businesses are among the principal industries in the Bank's market area and, as a result, the Bank's loan and collateral portfolios are, to some degree, concentrated in those industries.

The Bank has pledged loans totaling approximately $59.54 million to secure a line of credit with the Federal Home Loan Bank as discussed in Note 8.

NOTE 3 - LOANS - Continued

A summary of the changes in the allowance for loan losses as of December 31 follows:

	2007	2006
Balance at Beginning of Year	$ 1,042,417	$ 926,075
Additions to the Allowance Charged to Expense	663,678	170,000
Recoveries on Loans Charged Off	9,503	40,742
	1,715,598	1,136,817
Less Loans Charged Off	(733,185)	(94,400)
	$ 982,413	$ 1,042,417

The following is a summary of the investment in impaired loans, the related allowance for loan losses, income recognized thereon and information pertaining to nonaccrual and past due loans as of December 31:

	2007	2006
Recorded Investment in Impaired Loans	$ 300,000	$ -
Related Allowance for Loan Losses	$ 30,000	$ -
Average Recorded Investment in Impaired Loans	$ 139,750	$ -
Interest Income Recognized for Cash Payments	$ -	$ -
Total Nonaccrual Loans	$ 300,000	$ -
Total Loans Past-Due Nintey Days or More and Still Accruing	$ -	$ -

The Bank's one impaired and nonaccrual loan at December 31, 2007 is 50% guaranteed by the SBA.

The Bank also originates loans for sale to governmental agencies and institutional investors. At December 31, 2007 and 2006, the Bank was servicing approximately $4,884,522 and $2,567,099, respectively, in SBA loans previously sold.

NOTE 4 - PREMISES AND EQUIPMENT

A summary of premises and equipment as of December 31 follows:

	2007	2006
Leasehold Improvements	$ 745,552	$ 567,405
Furniture, Fixtures, and Equipment	1,046,376	947,807
	1,791,928	1,515,212
Less Accumulated Depreciation and Amortization	(1,320,335)	(1,169,176)
	$ 471,593	$ 346,036

The Bank has entered into leases for its bank premises, which expire at various dates through 2014. These leases include provisions for periodic rent increases as well as payment by the lessee of certain operating expenses. Rental expense relating to these leases was $561,505 (prior to $85,472 of sublease income) and $523,893 (prior to $88,068 of sublease income) for the periods ended December 31, 2007 and 2006, respectively.

The approximate future minimum annual payments for these leases by year are as follows:

2008	$ 552,384
2009	499,379
2010	499,379
2011	499,379
2012	499,379
Thereafter	582,609
	$ 3,132,509

The Bank has entered into several sub-lease agreements that expire December 31, 2008 and total approximately $75,000.

The minimum rental payments shown above are given for the existing lease obligations and are not a forecast of future rental expense.

NOTE 5 - DEPOSITS

At December 31, 2007, the scheduled maturities of time deposits are as follows:

Due in One Year or Less	$ 11,967,382
Due from One to Three Years	217,603
Due in Over Three Years	41,332
	$ 12,226,317

NOTE 6 - EMPLOYEE BENEFIT PLAN

The Bank adopted a 401(k) for its employees in 1999. Under the plan, eligible employees may defer a portion of their salaries. The plan also provides for discretionary Bank profit sharing contributions. The Bank made contributions of $40,543 and $70,991 for 2007 and 2006, respectively.

NOTE 7 - INCOME TAXES

The asset and liability method is used in accounting for income taxes. Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax basis of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse.

The provision (benefit) for income taxes consists of the following:

	2007	2006
Current:		
Federal	$ 70,009	$ -
State	72,641	800
	142,650	800
Deferred	106,000	(193,785)
	$ 248,650	$(192,985)

NOTE 7 - INCOME TAXES - Continued

A comparison of the federal statutory rate to the Bank's effective income tax rate follows:

	2007		2006	
	Amount	Rate	Amount	Rate
Federal Tax Rate	$ 174,000	34.0%	$ 485,000	34.0%
California Franchise Taxes, net of Federal Benefit	44,000	8.6%	107,000	7.5%
Change in Valuation Allowance	-	-	(793,000)	(55.6)%
Other Items - Net	30,650	6.0%	8,015	0.6%
Bank's Effective Rate	$ 248,650	48.6%	$(192,985)	(13.5)%

Deferred taxes are a result of differences between income tax accounting and generally accepted accounting principles with respect to income and expense recognition.

The following is a summary of the components of the net deferred tax asset accounts recognized in the accompanying statements of balance sheet:

	2007	2006
Deferred Tax Assets:		
Net Operating Loss Carryforward	$ 97,000	$ 185,000
Depreciation Differences	81,000	69,000
Allowance for Loan Loss	366,000	426,000
Available-for-Sale Securities	12,000	69,000
Other	113,000	38,000
	669,000	787,000
Deferred Tax Liabilities:		
Other	(67,000)	(22,000)
	(67,000)	(22,000)
Net Deferred Tax Assets	$ 602,000	$ 765,000

The Bank has net operating loss carryforwards of approximately $285,000 for federal income tax purposes. Net operating loss carryforwards will expire in 2024 for federal income tax purposes if not previously utilized.

The Bank is subject to federal income tax and California franchise tax. Federal income tax returns for the years ended December 31, 2006, 2005 and 2004 are open to audit by the federal authorities and California returns for the years ended December 31, 2006, 2005, 2004 and 2003 are open to audit by state authorities.

NOTE 8 - BORROWING ARRANGEMENTS

The Bank has a line of credit with the Federal Home Loan Bank (FHLB) secured by certain of its loans and assets of the Bank. As of December 31, 2007, this line had total financing availability of approximately $20.4 million and was collateralized by loans of approximately $59.4 million. As of December 31, 2007, the Bank had the following outstanding advances from the FHLB

Amount	Interest Rate	Maturity Date
$ 2,500,000	4.89%	1/17/2008
2,500,000	4.77%	4/17/2008
4,000,000	4.03%	12/29/2008
5,000,000	3.89%	11/30/2009
$ 14,000,000		

The Bank may also borrow up to $7,000,000 overnight on an unsecured basis from two correspondent banks. No amounts were outstanding under these arrangements as of December 31, 2007 and 2006.

NOTE 9 - STOCK OPTION PLAN

The Bank's 2006 Omnibus Stock Incentive Plan ("2006 Plan") was approved by its shareholders on May 25, 2006. The 2006 Plan replaces the Bank's 1998 Stock Option Plan and all existing options under the 1998 Plan became subject to the 2006 Plan. Under the 2006 Plan, directors, officers, employees and consultants may be granted options, stock appreciation rights, restricted stock awards, deferred stock awards and performance units and also allows for performance objectives upon which awards may be conditioned. The maximum number of shares as to which stock awards may be granted under the 2006 Plan is 429,358 shares. This reserved share amount is subject to adjustments for stock splits, stock dividends, recapitalization or similar transactions. The 2006 Plan also provides for accelerated vesting if there is a change in control, as defined in the Plan. The Bank recognized stock-based compensation cost of $165,921 and $82,023 and related tax benefits of $35,000 and $0 in 2007 and 2006, respectively.

The fair value of each option granted was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions presented below:

	2007	2006
Expected Volatility	20.25%	21.00%
Expected Term	6.48 Years	6.25 Years
Expected Dividends	None	None
Risk Free Rate	4.56%	4.61%
Weighted-Average Grant Date Fair Value	$ 5.19	$ 4.85

NOTE 9 - STOCK OPTION PLAN - Continued

The expected volatility is based on the historical volatility of the Bank over the expected term. The expected term represents the estimated average period of time that the options remain outstanding. Since the Bank does not have sufficient historical data on the exercise of stock options, the expected term is based on the "simplified" method that measures the expected term as the average of the vesting period and the contractual term. The risk free rate of return reflects the grant date interest rate offered for zero coupon U.S. Treasury bonds over the expected term of the options.

A summary of the status of the Bank's stock option plan as of December 31, 2007 and changes during the year ending thereon is presented below:

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at Beginning of Year	271,675	$ 10.68		
Granted	60,500	$ 15.74		
Exercised	(31,050)	$ 11.05		
Forfeited or Expired	(16,310)	$ 11.14		
Outstanding at End of Year	284,815	$ 11.69	6.4 Years	$ 89,000
Options Exercisable	214,465	$ 10.57	5.5 Years	$ 306,000

The total intrinsic value of the options exercised during the years ended December 31, 2007 and 2006 were approximately $155,000 and $23,000, respectively. As of December 31, 2007, there was $308,000 of total unrecognized compensation cost related to the outstanding stock options that will be recognized over a weighted average period of 2.7 years.

In 2007, the Bank granted 3,067 restricted shares of stock with grant date fair values of $17.50 and $16.30. These shares vest in five years from the date of grant. The Bank expensed approximately $7,000 in 2007 related to the grants. As of December 31, 2007, total deferred compensation costs related to the outstanding stock grants was $45,510.

NOTE 10 - COMMITMENTS

In the ordinary course of business, the Bank enters into financial commitments to meet the financing needs of its customers. These financial commitments include commitments to extend credit and standby letters of credit. Those instruments involve to varying degrees, elements of credit and interest rate risk not recognized in the Bank's financial statements.

The Bank's exposure to loan loss in the event of nonperformance on commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments as it does for loans reflected in the financial statements.

As of December 31, the Bank had the following outstanding financial commitments whose contractual amount represents credit risk:

	2007	2006
Undisbursed loan commitments	$ 32,189,000	$ 27,149,000
Standby letters of credit	550,000	285,000
	$ 32,739,000	$ 27,434,000

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. Since many of the commitments are expected to expire without being drawn upon, the total amounts do not necessarily represent future cash requirements. The Bank evaluates each client's credit worthiness on a case-by-case basis. The amount of collateral obtained if deemed necessary by the Bank is based on management's credit evaluation of the customer. The majority of the Bank's commitments to extend credit and standby letters of credit are secured by real estate.

NOTE 11 - RELATED PARTY TRANSACTIONS

In the ordinary course of business, the Bank has granted loans to certain officers and directors and the companies with which they are associated. In the Bank's opinion, all loans and loan commitments to such parties are made on substantially the same terms including interest rates and collateral, as those prevailing at the time of comparable transactions with other persons. The total outstanding balance of these loans at December 31, 2007 and 2006 was approximately $331,000 and $695,000, respectively.

Deposits from related parties held by the Bank at December 31, 2007 and 2006 amounted to approximately $1,299,000 and $1,919,000, respectively.

The Bank subleases certain office facilities to a director on a month by month basis. Rental income received on this lease during 2007 and 2006 was $10,800 annually.

The Bank expensed approximately $49,000 and $55,000 during 2007 and 2006, respectively, for legal fees to a firm having a member who is also a director of the Bank.

NOTE 12 - EARNINGS PER SHARE

The following is a reconciliation of net income and shares outstanding to the income and number of shares used to compute EPS:

	2007		2006	
	Income	Shares	Income	Shares
Net Income as Reported	$ 262,482		$ 1,619,024	
Shares Outstanding at Year End		1,477,587		1,446,537
Impact of Weighting Shares Purchased During the Year		(6,147)		(1,485)
Used in Basic EPS	262,482	1,471,440	1,619,024	1,445,052
Dilutive Effect of Outstanding Stock Options		57,227		55,651
Used in Dilutive EPS	$ 262,482	1,528,667	$ 1,619,024	1,500,703

NOTE 13 - REGULATORY CAPITAL REQUIREMENTS

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory - and possibly additional discretionary - actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined). Management believes, as of December 31, 2007, that the Bank meets all capital adequacy requirements to which it is subject.

The FDIC most recently categorized the Bank as well capitalized under the regulatory framework for capital adequacy purposes and there are no conditions or events since the last notification that Management believes have changed the Bank’s category. To be categorized as well capitalized, the Bank must maintain minimum ratios as set forth in the table below.

NOTE 13 - REGULATORY CAPITAL REQUIREMENTS - Continued

The following table also sets forth the Bank's actual capital amounts and ratios (dollar amounts in thousands):

	Actual		Amount of Capital Required: For Capital Adequacy Purposes		Amount of Capital Required: To Be Well-Capitalized Under Prompt Corrective Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2007:						
Total Capital (to Risk-Weighted Assets)	$ 16,167	17.10%	$ 7,566	8.0%	$ 9,457	10.0%
Tier 1 Capital (to Risk-Weighted Assets)	$ 15,103	15.97%	$ 3,783	4.0%	$ 5,674	6.0%
Tier 1 Capital (to Average Assets)	$ 15,103	14.20%	$ 4,253	4.0%	$ 5,317	5.0%
As of December 31, 2006:						
Total Capital (to Risk-Weighted Assets)	$ 15,382	15.53%	$ 7,924	8.0%	$ 9,904	10.0%
Tier 1 Capital (to Risk-Weighted Assets)	$ 14,272	14.41%	$ 3,962	4.0%	$ 5,943	6.0%
Tier 1 Capital (to Average Assets)	$ 14,272	12.32%	$ 4,633	4.0%	$ 5,791	5.0%

The California Financial Code provides that a bank may not make a cash distribution to its shareholders in excess of the lesser of the Bank’s undivided profits or the Bank’s net income for its last three fiscal years less the amount of any distribution made by the Bank to shareholders during the same period.

NOTE 14 - FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair value of a financial instrument is the amount at which the asset or obligation could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Fair value estimates are made at a specific point in time based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the entire holdings of a particular financial instrument. Because no market value exists for a significant portion of the financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature, involve uncertainties and matters of judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value estimates are based on financial instruments both on and off the balance sheet without attempting to estimate the value of anticipated future business, and the value of assets and liabilities that are not considered financial instruments. Additionally, tax consequences related to the realization of the unrealized gains and losses can have a potential effect on fair value estimates and have not been considered in many of the estimates.

NOTE 14 - FAIR VALUE OF FINANCIAL INSTRUMENTS - Continued

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

Financial Assets

The carrying amounts of cash, short-term investments, due from customers on acceptances and Bank acceptances outstanding are considered to approximate fair value. Short-term investments include federal funds sold, securities purchased under agreements to resell, and interest bearing deposits with Banks. The fair values of investment securities, including available for sale, are generally based on quoted market prices. The fair value of loans are estimated using a combination of techniques, including discounting estimated future cash flows and quoted market prices of similar instruments where available.

Financial Liabilities

The carrying amounts of deposit liabilities payable on demand, commercial paper, and other borrowed funds are considered to approximate fair value. For fixed maturity deposits, fair value is estimated by discounting estimated future cash flows using currently offered rates for deposits of similar remaining maturities. The fair value of long term debt is based on rates currently available to the Bank for debt with similar terms and remaining maturities.

Off-Balance Sheet Financial Instruments

The fair value of commitments to extend credit and standby letters of credit is estimated using the fees currently charged to enter into similar agreements. The fair value of these financial instruments is not material.

NOTE 14 - FAIR VALUE OF FINANCIAL INSTRUMENTS - Continued

The estimated fair value of financial instruments at December 31 is summarized as follows (amounts in thousands):

	2007		2006	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial Assets:				
Cash and Due from Banks	$ 4,733	$ 4,733	$ 8,319	$ 8,319
Federal Funds Sold	5,775	5,775	6,420	6,420
Time Deposits at Other Institutions	100	100	-	-
Investment Securities	6,077	6,077	7,939	7,939
Loans	86,677	86,453	88,642	88,063
Accrued Interest Receivable	428	428	403	403
Financial Liabilities:				
Deposits	76,829	76,815	91,248	91,202
FHLB Advances	14,000	13,977	8,003	8,003
Accrued Interest and Other Liabilities	609	609	636	636