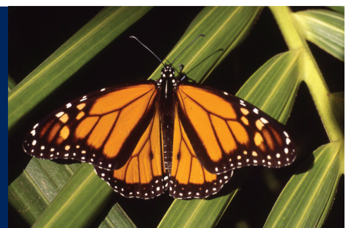
2007 Annual Report



Building for the future.

SANTA CRUZ COUNTY BANK

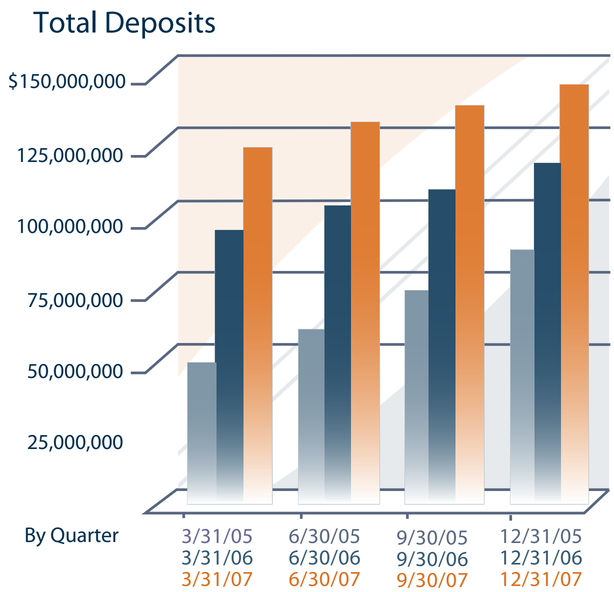
Put your money where your life is.

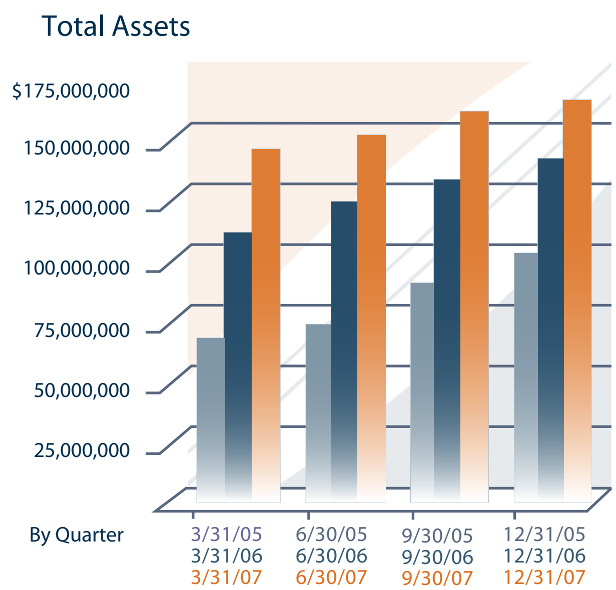
WHERE LOCALS BANK.

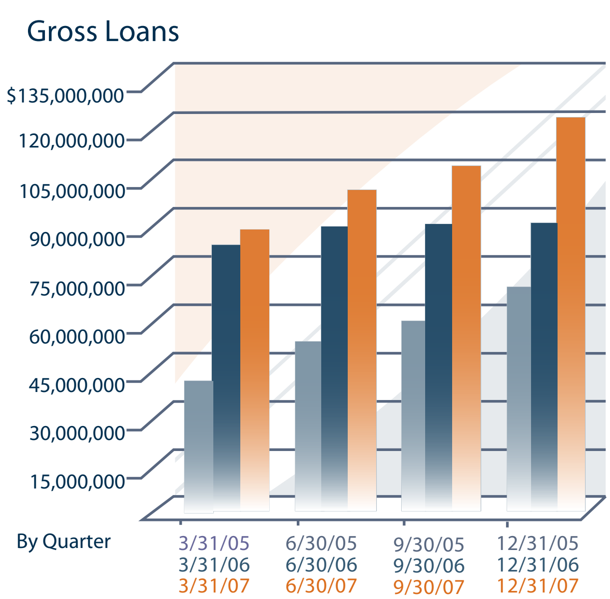
SANTA CRUZ COUNTY BANK is a locally owned and operated commercial bank, serving the needs of the residents and businesses of Santa Cruz County. We believe strongly in the importance of local decision making and responsive customer service. We offer a complete line of short and intermediate term loan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

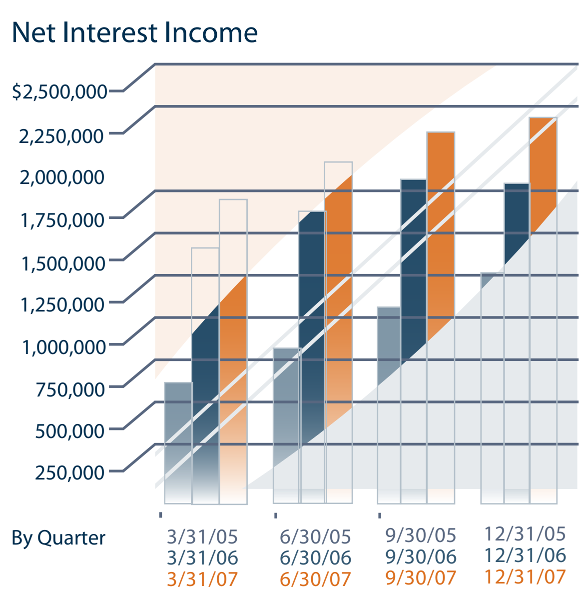
Santa Cruz County Bank operates four full service banking offices located in Capitola, Santa Cruz, Scotts Valley, and Watsonville, a Business Lending Office on 41st Avenue in Capitola, and two free standing ATM and Night Depositories in Santa Cruz and Aptos.

QUARTERLY GROWTH 2005, 2006, 2007









LETTER TO SHAREHOLDERS

To Our Shareholders, Employees, Clients, and Friends,

We are pleased to present our financial report for the year ended December 31, 2007. In 2007 we celebrated numerous milestones and made significant progress in executing our initiative of continued penetration and expansion of our market share within the County. Outlined below are the highlights of these milestones which have served to strengthen and grow your bank.

2007 Highlights

- In early 2007, we announced acknowledgement of the designation of Premier Performer for our performance in 2006 by Findley Reports, Inc., a highly regarded financial industry consulting firm.
- In May of 2007, we opened a dedicated Business Lending Office on 41st Avenue in Capitola which is home to our Small Business Administration (SBA) Department. This facility includes an ATM and Night Depository to provide greater access for our clients.
- In June of 2007, we opened our fourth full-service banking office at 819 Bay Avenue in Capitola. This office has grown to over $19 million in deposits in just ten months.
- In the Second Quarter of 2007, we achieved profitability on a cumulative basis, recovering our original start up costs, including organizational and pre-opening expenses. We are the only one of 11 banks opened in California in 2004 to achieve this.
- In the Second Quarter of 2007, we expanded our Small Business Administration (SBA) Department and ranked the #1 lender of SBA 7(a) loans in Santa Cruz County by the San Francisco District of the SBA.
- In the Third Quarter of 2007, we surpassed $150 million in assets.
- In the Third Quarter of 2007, the Bank launched its new Fast Track! product. Fast Track! is a Remote Electronic Deposit system which allows our business clients to process the depositing of checks at their business facility anytime of the day or night eliminating the need to come into the Bank or having to be tied to the schedule of a courier to make their deposits.
- In October of 2007, we extended banking hours Monday through Thursday to 9am-5pm and Friday 9am-6pm to provide greater convenience and access for our clients.
- In October of 2007, the Bank was awarded the ArtWORKS Emerging Business Award by the City of Santa Cruz Arts Commission for its support of the arts. The Bank has dedicated its walls to the display of artwork on an ongoing basis from the time we first opened our doors in February 2004.
- In the Fourth Quarter of 2007, we announced for the third consecutive year double-digit percentage increases (year to year) in total deposits, gross loans and total assets.
- For the Fourth Quarter of 2007, we achieved a 5-Star Rating (Superior) from Bauer Financial.

These milestones are a reflection of the breadth and depth of Santa Cruz County Bank's knowledgeable and experienced leadership team, as well as our reputation in the community as the local bank of choice. These achievements would not be possible without the loyalty and support from you, our clients, our shareholders, and our community, as well as our dedicated family of employees, now over 50 strong.

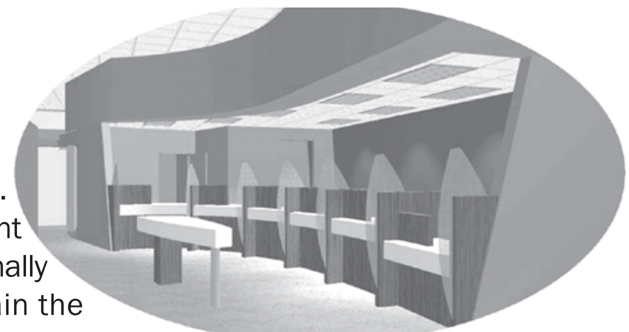
2008: LEADING THE WAY WITH A NEW LEED® CERTIFIED FACILITY

Since the time we opened our doors in February of 2004, we have made a commitment to be an environmentally aware and conscientious business. Our letterhead and brochures are printed on recycled paper, our furnishings are predominantly made from renewable or recycled materials and our purchases are made through local businesses whenever possible.

In 2008, we plan to relocate our Santa Cruz banking office to a highly visible location in the downtown financial corridor of Santa Cruz. We anticipate this move will attract business owners in the area who appreciate the convenience of walking to their bank to make deposits and get cash and coin for their retail establishments. The new office will also be adjacent to the growing number of owner occupied condominiums and residences being built in the downtown area. Our new facility will represent the County's first LEED for Commercial Interiors Certified Building and Bank designed to LEED Silver Certification standards of the U.S. Green Building Council. LEED is the acronym for Leadership in Energy and Environmental Design.

2008 AND BEYOND

The economic environment has entered a challenging period of volatility with mounting concerns over recession and inflation. While we are mindful of the uncertainties created by the current economic and financial landscape and its impact globally, nationally and locally, we believe we are in a unique position to sustain the growth of our business. Major factors contributing to this position are the opportunities being presented in the area of establishing new banking relationships and the ability of our very capable staff to service and enhance these relationships.



An architect's rendering of the Bank's future lobby and teller line. The Bank will relocate from its current facility at 325 Soquel Avenue to 720 Front Street in midyear 2008.

We have achieved significant growth and continue to see opportunities due to changes in the local banking landscape. Most significantly, the acquisition of Coast Commercial Bank by Wells Fargo Bank has resulted in the closure of three of Coast Commercial's former banking facilities in our market area in March 2008. During this transition, we have been very proactive with this opportunity to establish new relationships.

We encourage you to visit any of our four full service offices and our Business Lending Office to discover an extremely friendly, unique, and refreshing banking experience. You will see art on our walls, smiling faces and our commitment to customer service. Our number one focus is serving our clients and our community. Whether you've banked with us from the beginning or have not yet had the opportunity to visit any of our offices, we encourage you to come in for the art and stay for the banking!

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

George Gallucci
Chairman of the Board

David Heald
President & CEO

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

VALUE THE DIFFERENCE

INDEPENDENT AUDITORS' REPORT

The Board of Directors
Santa Cruz County Bank

We have audited the balance sheets of Santa Cruz County Bank as of December 31, 2007, and 2006 and the related statements of operations, changes in stockholders' equity and other comprehensive income, and cash flows for each of the years in the three year period ended December 31, 2007. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Santa Cruz County Bank as of December 31, 2007 and 2006 and the results of its operations and its cash flows for each of the years in the three year period ended December 31, 2007, in conformity with accounting principles generally accepted in the United States of America.

Vavrinek Trine Day + Co. LLP

Palo Alto, California
April 4, 2008

SANTA CRUZ COUNTY BANK

STATEMENTS OF CONDITION
December 31, 2007 and 2006

	December 31, 2007	December 31, Restated 2006
ASSETS		
Cash and due from banks (notes 1, 13 and 16)	$ 6,129,861	$ 3,725,075
Interest bearing deposits in other financial institutions	1,004,632	1,003,971
Federal funds sold	6,574,261	19,178,353
Total cash and cash equivalents	13,708,754	23,907,399
Investment securities (notes 1, 2 and 14):		
Securities held to maturity	1,048,149	1,264,059
Securities available for sale, at estimated fair value	19,900,590	18,624,988
Total investment securities	20,948,739	19,889,047
Bankers' Bank stock, at cost	619,600	346,900
Loans receivable (notes 1, 3, 13 and 16):		
Gross loans	119,226,597	82,538,994
less deferred loan fees, net of costs	269,164	245,423
less reserve for loan losses	1,788,000	1,276,000
Net loans	117,169,433	81,017,571
Premises and equipment, net (notes 1, 4 and 13)	1,570,471	1,360,146
Accrued interest receivable	672,218	712,627
Bank owned life insurance	3,460,653	3,331,971
Other assets	2,089,159	1,765,398
TOTAL ASSETS	$ 160,239,027	$ 132,331,059
LIABILITIES AND SHAREHOLDERS' EQUITY		
LIABILITIES		
Deposits (note 16):		
Non-interest bearing demand deposits	$ 44,200,647	$ 33,693,998
Interest bearing demand deposits	8,598,091	6,382,888
Savings and money market deposits	53,739,693	44,979,206
Time deposits (note 5)	32,470,437	27,925,451
Total deposits	139,008,868	112,981,543
Other liabilities		
Accrued interest payable	512,511	401,544
Other liabilities	1,745,898	1,474,465
Total liabilities	141,267,277	114,857,552
SHAREHOLDERS' EQUITY		
Common stock, no par value, 30,000,000 shares authorized; issued and outstanding; 1,662,340 shares at December 31, 2007 and 1,648,374 shares at December 31, 2006	18,574,863	18,429,623
Additional paid-in-capital	372,454	198,342
Accumulated income (deficit)	422,745	(557,477)
Accumulated other comprehensive loss (note 1)	(398,312)	(596,981)
Total Shareholders' equity	18,971,750	17,473,507
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 160,239,027	$ 132,331,059

See accompanying notes to the financial statements

SANTA CRUZ COUNTY BANK

STATEMENTS OF OPERATIONS
For the years ended December 31, 2007, 2006 and 2005

	Year Ended December 31, 2007	Restated Year Ended December 31, 2006	Year Ended December 31, 2005
INTEREST INCOME:			
Interest and fees on loans	$ 8,856,093	$ 7,283,351	$ 3,869,243
Investment securities	979,935	881,110	328,370
Federal funds sold and other interest income	1,028,629	529,078	327,625
Total interest income	10,864,657	8,693,539	4,525,238
INTEREST EXPENSE:			
Deposits (note 5) and other borrowed funds (note 7)	2,908,202	2,038,149	744,576
Net interest income before provision for loan losses	7,956,455	6,655,390	3,780,662
Provision for loan losses (notes 1 and 3)	512,000	436,000	433,000
Net interest income after provision for loan losses	7,444,455	6,219,390	3,347,662
NON-INTEREST INCOME:			
Service charges on deposit accounts	279,221	200,388	116,377
Other non-interest income (note 14)	851,056	570,758	291,243
Total non-interest income	1,130,277	771,146	407,620
NON-INTEREST EXPENSE:			
Salaries and employee benefits	4,266,507	3,419,206	2,616,119
Occupancy	569,577	455,606	384,864
Furniture and equipment	368,223	344,678	276,083
Marketing and business development	278,098	190,059	152,095
Item and data processing	238,238	181,022	146,617
Professional services	247,231	248,545	103,428
Other operating expenses (note 15)	894,382	670,765	490,350
Total non-interest expense	6,862,256	5,509,881	4,169,556
Income (loss) before income taxes	1,712,476	1,480,655	(414,274)
Income tax expense (benefit) (notes 1 and 6)	732,254	(557,017)	800
Net income (loss)	$ 980,222	$ 2,037,672	$ (415,074)
EARNINGS (LOSS) PER SHARE - BASIC	$ 0.59	$ 1.24	$ (0.29)
EARNINGS (LOSS) PER SHARE - DILUTED	$ 0.56	$ 1.16	$ (0.29)

See accompanying notes to the financial statements

SANTA CRUZ COUNTY BANK

STATEMENT OF SHAREHOLDERS' EQUITY
For the years ended December 31, 2007, 2006 and 2005

	Common Shares	Amount	Additional Paid In Capital	Accumulated Deficit	Other Comprehensive (loss) Income	Total Shareholders' Equity
Balance at December 31, 2004	1,320,000	13,123,400		(2,180,075)	(22,249)	10,921,076
Proceeds from stock offering, net of offering expenses of $37,647	294,117	4,962,342	-	-	-	4,962,342
Exercise of stock options	525	5,910	-	-	-	5,910
Net loss	-	-	-	(415,074)	-	(415,074)
Unrealized losses on securities available for sale	-	-	-	-	(126,360)	(126,360)
Balance at December 31, 2005	1,614,642	18,091,652	-	(2,595,149)	(148,609)	15,347,894
Exercise of stock options	33,732	337,971	-	-	-	337,971
Stock-based compensation	-	-	115,159	-	-	115,159
Net income	-	-	-	2,037,672	-	2,037,672
Tax benefit from exercise of non-qualified stock options	-	-	83,183	-	-	83,183
Additional minimum pension liability adjustment	-	-	-	-	(518,345)	(518,345)
Unrealized gain on securities available for sale	-	-	-	-	69,973	69,973
Balance at December 31, 2006 (Restated)	1,648,374	18,429,623	198,342	(557,477)	(596,981)	17,473,507
Exercise of stock options	13,966	145,240	-	-	-	145,240
Stock-based compensation	-	-	174,112	-	-	174,112
Net income	-	-	-	980,222	-	980,222
Amortization of pension cost FAS158	-	-	-	-	46,534	46,534
Unrealized gain on securities available for sale, net of tax of $48,999	-	-	-	-	152,135	152,135
Balance at December 31, 2007	1,662,340	18,574,863	372,454	422,745	(398,312)	18,971,750

SANTA CRUZ COUNTY BANK

STATEMENTS OF CASH FLOWS
For the years ended December 31, 2007, 2006 and 2005

	Year Ended December 31, 2007	Restated Year Ended December 31, 2006	Year Ended December 31, 2005
OPERATING ACTIVITIES:			
Net income (loss)	$ 980,222	$ 2,037,672	$ (415,074)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Income tax expense (benefit)	(293,966)	(557,817)	-
Depreciation and amortization of premises and equipment	387,572	376,890	318,089
Accretion of discounts, net of amortization for investments	(38,731)	(48,269)	(497)
Net other amortization and accretion	138,437	28,409	79,243
Increase (decrease) in deferred loan fees, net of costs	23,741	(21,465)	82,341
Provision for loan losses	512,000	436,000	433,000
Increase in cash value of bank owned life insurance	(128,682)	(123,077)	(118,516)
(Gain) on sale of available-for-sale securities	-	-	-
(Gain) on sale of SBA loans	(349,341)	(236,941)	(81,712)
Stock-based compensation	174,112	115,159	-
Decrease (increase) in accrued interest receivable	40,409	(315,860)	(269,919)
Increase in other assets	(80,947)	(429,083)	(41,341)
Increase in accrued interest payable	110,967	244,086	118,068
Increase in other liabilities	166,467	218,953	200,820
Net cash provided by operating activities	1,642,260	1,724,657	304,502
INVESTING ACTIVITIES:			
Held-to-maturity securities:			
Principal repayments	212,709	247,621	289,206
Available-for-sale securities:			
Maturities/Calls	16,225,000	4,000,000	1,000,000
Principal repayments	656,452	617,123	553,179
Purchases	(17,913,988)	(8,173,866)	(12,912,392)
Increase in Federal Home Loan Bank stock	(102,700)	(187,600)	(32,100)
Purchase of Pacific Coast Bankers' Bank stock	(170,000)	-	-
Net proceeds from sales of loans	4,016,839	2,788,764	988,593
Net increase in loans	(40,339,885)	(20,409,068)	(33,114,945)
Purchase of premises and equipment	(606,468)	(142,089)	(766,714)
Disposal of equipment	8,571	-	-
Net cash used by investing activities	(38,013,470)	(21,259,115)	(43,995,173)
FINANCING ACTIVITIES:			
Net proceeds from sale of common stock	145,240	337,971	4,968,252
Increase in demand deposits	12,721,852	11,430,144	16,072,275
Increase in savings and money market deposits	8,760,487	5,300,528	24,716,546
Increase in time deposits	4,544,986	14,566,020	7,100,575
Net cash provided by financing activities	26,172,565	31,634,663	52,857,648
Net increase (decrease) in cash and cash equivalents	(10,198,645)	12,100,205	9,166,977
Cash and cash equivalents at beginning of period	23,907,399	11,807,194	2,640,217
Cash and cash equivalents at end of period	$ 13,708,754	$ 23,907,399	$ 11,807,194
Supplemental Disclosures of Cash Flow Information			
Total interest paid	$ 2,797,235	$ 1,794,064	$ 626,508
Total income taxes paid	788,270	800	800

SANTA CRUZ COUNTY BANK

NOTES TO FINANCIAL STATEMENTS

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of the Business

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

The majority of the Bank's business is conducted with customers located in Northern California, specifically in Santa Cruz and adjacent counties. The Bank has 271 credit arrangements that are collateralized by real estate. Generally, the Bank maintains loan-to-value ratios no greater than 70 percent on commercial and multi-family real estate loans and no greater than 75 percent on single-family residential real estate loans. At December 31, 2007, the Bank had loans outstanding of approximately $91,130,000 that were collateralized by real estate. There were no other significant loan concentrations.

Summary of Significant Accounting Policies

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

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

Investment Securities: Marketable investment securities consist of U.S. Government Agency and mortgage-backed 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 or accretion of premiums or discounts. Available for sale securities are recorded at fair value with unrealized holding gains and losses, net of the related tax effect, reported as a separate component of shareholders' equity until realized. During the year ended December 31, 2007, there were no transfers between classifications. Premiums and discounts are amortized or accreted over the life of the related security as an adjustment to yield using the interest method, except for securities with early call provisions, in which case premiums are recognized in interest income using the interest method over the period to the first call date and discounts are recognized in interest income using the interest method over the period to the contractual maturity date. Dividend and interest income are recognized on an accrual basis. Realized gains and losses for securities classified as available for sale and held to maturity are included in earnings and are derived using the specific identification method for determining the cost of securities sold.

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

Loans: Loans are stated at the amount of unpaid principal, net of deferred loan fees, and reduced by the allowance for loan losses. Accrual of interest is generally discontinued on loans which are more than 90 days delinquent or when Management believes, after considering economic and business conditions and collection efforts, that the borrower's financial condition is such that collection of interest is doubtful unless the loans are well-secured and in the process of collection. When a loan is placed on non-accrual status, all interest previously accrued but not collected is reversed from current period income. Income on such loans is then recognized only to the extent that cash is received and where the future collection of principal is probable.

Generally, a non-accrual loan will be restored to an accrual status when none of its principal and interest is past due, when prospects for future contractual payments are no longer in doubt and when the loan becomes well-secured and in the process of collection. The Bank did not have any non-accrual loans at December 31, 2007, had two non-accrual loans totaling $79,000 at December 31, 2006 and one non-accrual loan totaling $440,000 at December 31, 2005.

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

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

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

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

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

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

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

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

Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to the carrying amount. Impairment is determined by stratifying rights into groupings based on predominant risk characteristics, such as interest rate, loan type and investor type. For purposes of measuring impairment, the Bank has identified each servicing asset with the underlying loan being serviced. A valuation allowance is recorded where the fair value is below the carrying amount of the asset. If the Bank later determines that all or a portion of the impairment no longer exists for a particular grouping, a reduction of the allowance may be recorded as an increase to income. The fair values of servicing rights are subject to significant fluctuations as a result of changes in estimated and actual prepayment speeds and changes in the discount rates.

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

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

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, three to seven years, and are expensed to non-interest expense. Leasehold improvements are amortized over their estimated useful lives, seven years, or the initial term of the respective leases, whichever is longer. Certain operating leases contain incentives in the form of tenant improvement allowances or credits. Lease incentives are capitalized at the inception of the lease and amortized on a straight-line basis over the lease term. Gains and losses on disposition of premises and equipment are accounted for under the specific identification method.

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

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

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

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

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

Stock-Based Compensation. The Bank has elected the modified prospective transition method as permitted by SFAS No. 123R and accordingly prior periods have not been restated to reflect the impact of SFAS No. 123R. The modified prospective transition method requires that stock-based compensation expense be recorded for all new and unvested stock options, restricted stock, restricted stock units, and employee stock purchase plan shares that are ultimately expected to vest as the requisite service is rendered beginning on January 1, 2006, the first day of the Bank's fiscal year 2006. Stock-based compensation expense for awards granted prior to January 1, 2006 is based on the grant date fair value as determined under the pro forma provisions of SFAS No. 123. During 2007 and 2006, the Bank recorded pre-tax stock based compensation expense of $174,112 and $115,159, $153,290 and $93,759 net of related tax benefits, respectively, as a result of the adoption of SFAS No. 123R. For the years ended December 31, 2007 and 2006, the impact of implementing SFAS No. 123R reduced basic earnings per share by $.09 and $.06, respectively, and diluted earnings per share by $0.08 and $0.06, respectively.

No stock-based compensation costs were capitalized as part of the cost of an asset as of December 31, 2007. During 2007, $154,000 of total unrecognized compensation cost related to stock options is expected to be recognized over a weighted-average period of 4 years.

Prior to the adoption of SFAS No. 123R, the Bank measured compensation expense for its employee stock-based compensation plans using the intrinsic value method prescribed by APB Opinion No. 25. The Bank applied the disclosure provisions of SFAS No. 123 as amended by SFAS No. 148, Accounting for Stock-Based Compensation - Transition and Disclosure as if the fair-value-based method had been applied in measuring compensation expense. Under APB Opinion No. 25, when the exercise price of the Bank's employee stock options was equal to the market price of the underlying stock on the date of the grant, no compensation expense was recognized.

Had compensation cost for the Bank's stock option plans been determined based on the fair value at the grant dates for awards under those plans consistent with the method of SFAS No. 123, during 2005, the Bank's net loss and loss per share would have been increased to the pro forma amounts indicated below:

		2005
Net Loss:		
As reported	$	(415,074)
Stock-based compensation using intrinsic value method:		
Stock-based compensation that would have been reported using the fair value method of SFAS 123		(127,896)
Pro forma	$	(542,970)
Earnings (loss) per share:		
As reported	$	(0.29)
Pro forma	$	(0.38)

Earnings Per Share: SFAS No. 128, *Measurement of Earnings per Share*, establishes standards for computing and reporting basic earnings per share and diluted earnings per share. Basic earnings per share are calculated by dividing net earnings for the period by the weighted-average common shares outstanding for that period. Diluted earnings per share takes into account the potential dilutive impact of such instruments and uses the average share price for the period in determining the number of incremental shares to add to the weighted-average number of shares outstanding. There is no adjustment to the number of outstanding shares for potential dilutive instruments, such as stock options, when a loss occurs because the conversion of potential common stock is anti-dilutive. The following table summarizes the weighted average shares outstanding used to compute earnings per share:

	Year ended December 31, 2007	2006	2005
Net Income (loss), as reported	$ 980,222	$ 2,037,672	$ (415,074)
Earnings (loss) per share, basic	$ 0.59	$ 1.24	$ (0.29)
Earnings (loss) per share, diluted	$ 0.56	$ 1.16	$ (0.29)
Weighted average shares outstanding, basic	1,653,017	1,640,528	1,428,300
Weighted average shares outstanding, diluted	1,737,325	1,761,684	1,428,300

Comprehensive Income: SFAS No. 130, "Reporting Comprehensive Income" requires that all items recognized under accounting standards as components of comprehensive earnings be reported in an annual financial statement that is displayed with the same prominence as other annual financial statements. This Statement also requires that an entity classify items of other comprehensive earnings by their nature in the annual financial statements. Other comprehensive earnings include the SFAS No. 158 adjustment to fully recognize the liability associated with the supplemental executive retirement plan and unrealized gains and losses, net of tax, on marketable securities classified as available for sale. The Bank had accumulated other comprehensive losses, net of tax of ($398,312) at December 31, 2007, ($596,981) at December 31, 2006 and ($148,609) at December 31, 2005.

	Year ended December 31, 2007	2006	2005
Net income (loss)	$ 980,222	$ 2,037,672	$ (415,074)
FASB 158 adjustment	46,534	(518,345)	-
Unrealized gain (loss) on securities available for sale	152,135	69,973	(126,360)
Total comprehensive income (loss)	$ 1,178,891	$ 1,589,300	$ (541,434)

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

However, considerable judgment is required to develop the estimates of fair value. Accordingly, the estimates are not necessarily indicative of the amounts the Bank could have realized in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

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

Restatement

The 2006 financial statements have been restated to correct an error in the calculation of the Bank's deferred tax asset balance as of December 31, 2006. The impact of the restatement is to reduce the previously reported deferred tax asset, the income tax provision credit in the income statement and retained earnings by $130,000.

Recent Accounting Announcements

Accounting for Certain Hybrid Financial Instruments: In February 2006, the Financial Accounting standards Board released SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments". SFAS No. 155 is an amendment of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities", and SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities". SFAS No. 155 establishes, amount other items, the accounting for certain derivative instruments embedded within other types of financial instruments; and eliminates a restriction on the passive derivative instruments that a qualifying special-purpose entity may hold. Effective for the Company for January 1, 2007, SFAS No. 155 did not have any impact on our financial position, results of operations or cash flows.

Accounting for Servicing of Financial Assets: In March 2006, the Financial Accounting standards Board released SFAS No. 156, "Accounting for Servicing of Financial Assets", an amendment of SFAS Statement No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities". SFAS No. 156 amends SFAS No. 140 to require that all separately recognized servicing assets and liabilities in accordance with SFAS No. 140 be initially measured at fair value, if practicable. Furthermore, this standard permits, but does not require fair value measurement for separately recognized servicing assets and liabilities in subsequent reporting periods. SFAS No. 156 is also effective for the Company beginning January 1, 2007; however, the adoption of this standard did not have a material impact on the Company's financial position, results of operations or cash flows.

Fair Value Measurements: In September 2006, the Financial Accounting Standards Board ("FASB") issued Statement No. 157 ("SFAS 157"), "Fair Value Measurements". SFAS 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS 157 applies whenever other standards require (or permit) assets or liabilities to be measured at fair value but does not expand the use of fair value in any new circumstances. In this standard, the FASB clarifies the principle that fair value should be based on the assumptions market participants would use when pricing the asset or liability. In support of this principle, SFAS 157 establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. The provisions of SFAS 157 are effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The provisions should be applied prospectively, except for certain specifically identified financial instruments. The Bank adopted SFAS 157 on January 1, 2008 and management does not believe its adoption will have a material impact on the Bank's financial position, results of operations, or cash flows.

The Fair Value Option for Financial Assets and Financial Liabilities –Including an amendment of FASB Statement No. 115: 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", which permits entities to choose to measure many financial instruments and certain other items at fair value. The objective of SFAS No. 159 is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. The entity will report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. The fair value option: (i) may be applied instrument by instrument, with a few exceptions, such as investments otherwise accounted for by the equity method; (ii) is irrevocable (unless a new election date occurs); and (iii) is applied only to entire instruments and not to portions of instruments. The provisions of SFAS No. 159 are effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. The Bank adopted SFAS 159 on January 1, 2008 and management did not elect the fair value option for any of its financial instruments.

Accounting for Business Combinations: In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141 (revised 2007), "Business Combinations" ("SFAS No. 141(R)"). SFAS No. 141(R), among other things, establishes principles and requirements for how the acquirer in a business combination: (i) recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in the acquired business; (ii) recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase; and (iii) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. The Bank is required to adopt SFAS No. 141(R) for all business combinations for which the acquisition date is on or after January 1, 2009. Earlier adoption is prohibited. This standard will change the accounting treatment for business combinations on a prospective basis.

Reclassifications

Certain reclassifications have been made in the 2006 and 2005 financial statements to conform to the presentation used in 2007. These reclassifications had no impact of the Bank's previously reported financial statements.

NOTE 2. INVESTMENT SECURITIES

The following table summarizes the carrying amount and the approximate fair values of Santa Cruz County Bank's securities held to maturity and available for sale at December 31, 2007, and December 31, 2006. "U.S. Agency" refers to the Federal National Mortgage Association ("FNMA"), the Federal Home Loan Mortgage Corporation ("FHLMC"), Federal Home Loan Bank ("FHLB") and Federal Farm Credit Bank ("FFCB"). Mortgage-backed securities are labeled as "MBS."

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

December 31, 2006	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Securities available for sale:				
U.S. Agency Securities	$ 16,188,465	$ 14,890	$ (40,119)	$ 16,163,236
U.S. Agency MBS's	2,515,159	-	(53,407)	2,461,752
Total securities available for sale	$ 18,703,624	$ 14,890	$ (93,526)	$ 18,624,988
Securities held to maturity:				
U.S. Agency MBS's	$ 1,264,059	$ -	$ (46,638)	$ 1,217,421
Total securities held to maturity	$ 1,264,059	$ -	$ (46,638)	$ 1,217,421

The amortized cost and estimated fair value of investment securities at December 31, 2007 and December 31, 2006, by contractual maturity, are shown in the following table, except for mortgage-backed securities and other securities which are presented in total. Expected maturities may differ from contractual maturities because borrowers may have the option to prepay principal and rights of issuers to call obligations prior to maturity with or without prepayment penalties.

	Securities available for sale		Securities held to maturity	
December 31, 2007	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due after one year through five years	$ 1,999,605	$ 2,012,190	$ -	$ -
Due after five years through ten years	5,997,075	6,043,380	-	-
Mortgage-backed securities	9,795,700	9,859,308	1,048,149	1,027,970
Total	$ 17,792,380	$ 17,914,878	$ 1,048,149	$ 1,027,970
December 31, 2006				
Due in one year or less	$ 13,188,465	$ 13,148,966	$ -	$ -
Due after one year through five years	1,000,000	1,005,000	-	-
Due after five years through ten years	2,000,000	2,009,270	-	-
Mortgage-backed securities	2,515,159	2,461,752	1,264,059	1,217,421
Total	$ 18,703,624	$ 18,624,988	$ 1,264,059	$ 1,217,421

Investment securities in a temporary unrealized loss position as of December 31, 2007 are shown in the following table, based on the time they have been continuously in an unrealized loss position:

	Less than Twelve Months		Over Twelve Months		Total Unrealized Losses	
December 31, 2007:	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses
Securities available for sale:						
U.S. Agency Securities	$ 999,380	$ (620)	$ -	$ -	$ 999,380	$ (620)
U.S. Agency MBS's	995,955	(1,501)	1,355,027	(15,671)	2,350,982	(17,172)
	$ 1,995,335	$ (2,121)	$ 1,355,027	$ (15,671)	$ 3,350,362	$ (17,792)

No investment securities were sold in 2007 or 2006. Investment securities required to be pledged to secure public deposits or for other purposes, required or permitted by law, at December 31, 2007 and December 31, 2006, were $4,966,685 and $3,407,523, respectively.

NOTE 3. LOANS RECEIVABLE

Loan maturity and rate sensitivity data of the loan portfolio, in thousands, at December 31, 2007 and 2006 are as follows:

	December 31, 2007			
	Within One Year	One to Five Years	After Five Years	Total
December 31, 2007				
Real estate and construction	$ 32,564	$ 4,277	$ 23,637	$ 60,478
Consumer, other	12,673	254	28	12,955
Commercial and revolving lines	35,299	4,338	6,157	45,794
	$ 80,536	$ 8,869	$ 29,822	$ 119,227
Loans at fixed interest rates	$ 5,054	$ 8,297	$ 22,297	$ 35,648
Loans at variable interest rates	75,482	572	7,525	83,579
	$ 80,536	$ 8,869	$ 29,822	$ 119,227
December 31, 2006				
Real estate and construction	$ 25,222	$ 5,344	$ 14,723	$ 45,289
Consumer, other	551	648	2,860	4,059
Commercial and revolving lines	17,606	9,958	5,627	33,191
	$ 43,379	$ 15,950	$ 23,210	$ 82,539
Loans at fixed interest rates	$ 3,602	$ 6,412	$ 12,975	$ 22,989
Loans at variable interest rates	39,777	9,538	10,235	59,550
	$ 43,379	$ 15,950	$ 23,210	$ 82,539

Changes in the allowance for loan losses are as follows:

	December 31,		
	2007	2006	2005
Balance at beginning of year	$ 1,276,000	$ 840,000	$ 407,000
Provision for loan losses	512,000	436,000	433,000
Loan charge-offs	79,117	-	-
Recoveries of loan charge-offs	79,117	-	-
Balance at year end	$ 1,788,000	$ 1,276,000	$ 840,000

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

	December 31,		
	2007	2006	2005
Impaired Loans:			
Recorded investment in impaired loans	$ -	$ 79,000	$ 440,000
Related allowance for loan losses	$ -	$ 37,000	$ 44,000
Average recorded investment in impaired loans	$ 32,000	$ 44,000	$ 30,000
Interest income recognized for cash payments while impaired	$ -	$ -	$ -
Total loans on non-accrual	$ -	$ 79,000	$ 440,000
Total loans past due 90 days or more and still accruing interest	$ 286,000	$ -	$ -

NOTE 4. PREMISES AND EQUIPMENT

The following presents the cost of premises and equipment including leasehold improvements and the related accumulated depreciation and amortization at December 31, 2007 and December 31, 2006:

	December 31, 2007	December 31, 2006
Leasehold improvements	$ 1,211,853	$ 941,470
Furniture, fixtures and equipment	1,185,550	913,037
Software and capitalized data & item processing	113,664	100,997
Computer equipment	283,301	243,843
Construction-in-progress	20,110	17,233
Total premises and equipment	2,814,478	2,216,580
Less accumulated depreciation and amortization	(1,244,007)	(856,434)
Premises and equipment, net	$ 1,570,471	$ 1,360,146

Depreciation expense aggregated $387,000 for the year ended December 31, 2007 and $377,000 for the year ended December 31, 2006.

NOTE 5. TIME DEPOSITS

The aggregate amount of time deposit accounts equal to or greater than $100,000 was approximately $21,815,000 and $18,571,000 at December 31, 2007 and December 31, 2006, respectively. At December 31, 2007 the scheduled maturities for time deposits were as follows:

(Rounded to the nearest thousand)	
Due in 2008	$ 31,592
Due in 2009	528
Due in 2010	119
Due in 2011	222
Due in 2012	9
	$ 32,470

Interest expense on time deposits of $100,000 or more was $868,073 and $567,644 in 2007 and 2006, respectively.

NOTE 6. INCOME TAXES

Deferred income taxes are the result of differences between income tax accounting and accounting principles generally accepted in the United States of America, with respect to income and expense recognition. The tax effects of temporary differences that gave rise to deferred tax assets and deferred tax liabilities at December 31, 2007, 2006, and 2005 are as follows:

	2007	Restated 2006
Deferred pre-opening costs plus NOL's	$ 44,000	$ 192,000
Fixed assets	(38,000)	(52,000)
Allowance for loan losses	481,000	307,000
Accrual to cash adjustments	221,000	47,000
State income tax	204,000	134,000
Other	23,000	13,000
	935,000	641,000
Valuation allowance	-	-
Net deferred tax asset	$ 935,000	$ 641,000

In addition to the above deferred tax asset, the Bank has additional deferred tax assets arising from adjustments to other comprehensive income aggregating $330,000 as of December 31, 2007.

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

	2007	2006
Current:		
Federal	$ 790,447	$ -
State	235,773	800
Total current	1,026,220	800
Deferred:		
Federal	$ (222,661)	$ (353,631)
State	(71,305)	(204,186)
Total deferred	(293,966)	(557,817)
Total provision (credit)	$ 732,254	$ (557,017)

The effective tax rate differs from the federal statutory rate as follows for the years ended December 31, 2007 and 2006:

	Year ended December 31, 2007	2006
Federal statutory rate	34.00%	34.00%
State income tax, net of federal effect	6.31%	6.83%
Stock based compensation	2.42%	2.65%
Net operating losses - current	0.00%	(52.58%)
Other	(2.79%)	0.00%
Reduction in valuation allowance	0.00%	(28.52%)
Net	39.94%	(37.62%)

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

NOTE 7. BORROWED FUNDS

The Bank has obtained federal funds borrowing guidance lines with its correspondent banks in an aggregate amount of $9.0 million on an unsecured basis. In addition, the Bank has established a secured borrowing arrangement, secured by its investment portfolio, with the Federal Home Loan Bank, in an amount equal to approximately 98% of the fair market value of the Bank's investment securities portfolio. The Bank recognized less than one thousand of borrowing expense in 2007 and $7,000 during 2006. The Bank had no borrowed funds at December 31, 2007 and at December 31, 2006. As of December 31, 2007, the Bank had an available line of credit with the Federal Home Loan Bank of San Francisco ("FHLBSF") secured by the assets of the Bank. Under this line, the Bank may borrow up to $22,312,000 subject to providing adequate collateral and continued compliance with the Advances and Security Agreement and other eligibility requirements established by the FHLBSF. As of December 31, 2007, no amounts were outstanding under these arrangements.

NOTE 8. 401(K) EMPLOYEE BENEFIT PLAN

All employees of the Bank, after completing 90 days of service, are eligible to participate in the Bank's 401(k) Plan which is a tax-deferred savings plan designed to assist employees in preparing for their retirement years. Employees may contribute to the Plan up to certain limits prescribed by the Internal Revenue Service. To date, the Bank does not match employee contributions.

NOTE 9. STOCK OPTIONS

The Bank has adopted a qualified stock option plan (the Plan) for employees, non-employee directors and Bank founders, under which a maximum of 396,000 shares of Bank's common stock may be issued. The Plan calls for the exercise prices of the options to be equal to or greater than the fair market value of the stock at the time of grant. Options granted to Bank founders who are not also Bank directors or Bank officers were fully vested upon the date of grant. All other options shares granted have daily vesting over the first four years of the option contract. All option contracts for founders who are not also Bank directors or Bank officers have expiration dates of ten years from the date of grant. All director and employee option contracts have expiration dates on the earlier of termination of service or 10 years from the date of grant.

The following is a summary of the status relating to the Bank's stock option plan as of December 31, 2007 and changes during the year as follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value
Options outstanding at beginning of year	267,947	$11.42		
Granted	16,250	$22.44		
Exercised	(13,966)	$10.40		
Forfeited or expired	(7,334)	$21.78		
Options outstanding at end of year	262,897	$11.88	6.49 years	$1,650,231
Options exercisable	231,323	$10.63	6.20 years	$1,612,495

The number and weighted average grant date fair value of options granted is as follows for the years ended December 31, 2007, 2006, and 2005:

	Number	Weighted Average Grant Date Fair Value
2007	16,250	$9.04
2006	20,700	$5.07
2005	4,700	$3.50

The aggregate intrinsic value of options exercised is as follows for the years ended December 31, 2007, 2006, and 2005:

2007	$ 176,534
2006	$ 587,693
2005	$ 4,590

The fair value of each option grant was estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions used for 2007, 2006, and 2005 as follows:

	2007	2006	2005
Expected life (yrs.)	6.25	5	5
Volatility	31.00%	0.00%	0.00%
Risk free rate of return	4.43%	4.50%	4.41%
Dividend yield	0.00%	0.00%	0.00%

NOTE 10. BANK OWNED LIFE INSURANCE

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

NOTE 11. RELATED PARTY TRANSACTIONS

In the ordinary course of business, the Bank makes loans to directors, officers, shareholders and their associates on substantially the same terms, including interest rates, origination and commitment fees, and collateral, as comparable transactions with unaffiliated persons, and such loans do not involve more than the normal risk of collectability. At December 31, 2007, December 31, 2006 and December 31, 2005, no related party loans were on non-accrual or classified for regulatory reporting purposes.

Total loans and extensions of credit made to or guaranteed by the Bank's directors and officers and their related companies totaled $824,000, $946,500, and $686,500 at December 31, 2007, December 31, 2006, and December 31, 2005, respectively. Loan related activity to directors, officers and principal shareholders and their associates for the years ended December 31, 2007, December 31, 2006, and December 31, 2005 is as follows:

	2007	2006	2005
Balance at beginning of year	$ 140,017	$ 34,989	$ 953
New loans or disbursements	987,836	735,072	117,799
Principal repayments	821,748	630,044	83,763
Balance at end of year	$ 306,105	$ 140,017	$ 34,989

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, 2007 and 2006.

	Year ended December 31, 2007	Year ended December 31, 2006
Change in benefit obligation		
Benefit obligation at the beginning of the year	$ 1,021,127	$ 1,076,856
Service cost	-	-
Interest cost	72,427	55,872
Amendments	-	-
Acturial (gains)/losses	51,870	(111,601)
Acquisitions/ (disvestitures)	-	-
Expected benefits paid	-	-
Projected benefit obilgation at the end of the year	1,145,424	1,021,127
Funded status	(1,145,424)	(1,021,127)
Unrecognized net acturial (gain) loss	90,558	38,693
Unrecognized prior service cost	763,095	842,163
Unrecognized net transition obligation (assets)	-	-
(Accrued)/ prepaid benefit cost	(291,771)	(140,271)
Accrued Benefit Liability	(1,145,424)	(1,021,127)
Accumulated Other Comprehensive Expense (Income)	853,653	880,856
Net Amount Recognized	$ (291,771)	$ (140,271)
Weighted average assumptions to determine benefit obligation as of December 31:		
Discount rate	6.75%	6.75%
Rate of compensation increase	N/A	N/A

The components of net periodic benefit cost recognized for the years ended December 31, 2007 and 2006 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, 2008 are as follows:

	Year ended December 31, 2008	2007	2006
Components of net periodic benefit cost			
Service cost	$ -	$ -	$ -
Interest Cost	77,316	72,427	55,872
Expected return on plan assets	-	-	-
Amortization of transition obligation (asset)	-	-	-
Amortization of prior service cost	79,068	79,068	79,068
Amortization of acturial (gains)/ losses	-	-	(10,992)
Net periodic benefit cost	$ 156,384	$ 151,495	$ 123,948

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. As of December 31, 2007 and December 31, 2006, Santa Cruz County Bank's reserve requirement was $1,399,000 and $876,000, respectively.

As compensation for check clearing and other services, compensating balances of approximately $10,000 were maintained with correspondent banks at December 31, 2007 and 2006. 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 current operating lease for the Santa Cruz Office at 325 Soquel Avenue commenced on September 18, 2003 and expires September 18, 2008. The Bank will not exercise its option to extend the lease period. The monthly lease payment for the Santa Cruz Office is presently $9,314 plus an allocation of 81.00% for triple net expenses for taxes, insurance and maintenance and is subject to increases of approximately 4% annually during the initial term.

The lease for the Bank's Scotts Valley Office at 4604 Scotts Valley Drive commenced on October 1, 2004, and expires on June 30, 2011, with an option to extend for two additional 5 year periods. The monthly lease payment for the Scotts Valley Office is presently $2,600 and will continue at this amount through the sixtieth month, after which it is subject to annual CPI increases. The first fifteen months of the Scotts Valley Office lease were rent free. The straight-line rent expense for the sixty month period is approximately $2,100 per month. Triple net expenses of 20.9% will be incurred in addition to these lease payments.

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

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

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

The Bank is relocating its main office located in Santa Cruz at 325 Soquel Avenue to 720 Front Street. The Bank entered into a lease for the property located at 720 Front Street effective December 4, 2006 which will commence sixty days after the Landlord's Delivery of Possession, which is expected to be in the second quarter of 2008. The lease expires ten years from the rent commencement date, with an option to extend for two additional 5 year periods. Base rent for the initial term of the lease is fixed at $17,280 monthly plus an allocation of 12.22% for triple net expenses and adjusts annually on the lease anniversary date equal to the annual percentage increase that occurs in the Consumer Price Index, but no less than 3% and not more than 6%.

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

Year ending December 31,	
2008	$ 402,687
2009	415,624
2010	416,732
2011	384,050
2012	345,701
Thereafter	1,757,986
	$ 3,722,780

Building and kiosk rent expense for the year ended December 31, 2007 and December 31, 2006, was $264,288 and $193,222 respectively.

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

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

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

Standby letters of credit and financial guarantees written are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Financial instruments whose contract amounts represent credit risk at December 31, 2007 and December 31, 2006 are as follows:

	December 31, 2007	December 31, 2006
Commitments to extend credit	$ 53,664,833	$ 40,477,061
Standby letters of credit	2,954,166	2,425,065
	$ 56,618,999	$ 42,902,126

Legal Matters: The Bank is subject to certain legal proceedings arising in the normal course of business. At December 31, 2007, the Bank was not subject to any claims and/or lawsuits.

NOTE 14. OTHER OPERATING INCOME AND EXPENSE

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

	December 31, 2007	December 31, 2006
Other non-interest income:		
BOLI non-interest income	$ 128,682	$ 123,077
Gain on sale of loans	349,341	236,941
Other non-interest income	373,033	210,740
Total other non-interest income	$ 851,056	$ 570,758
Other non-interest expense:		
Stationery, supplies and printing	$ 83,696	$ 76,314
Armored car and messenger	76,877	84,552
Telephone, postage and electronic communication	68,068	59,642
Correspondent bank charges	112,504	72,512
Insurance and security	48,408	43,599
Loan and collection expense	57,970	41,706
ATM related expenses	84,219	64,540
Shareholder related expense	45,419	25,044
Regulatory assessments	125,948	35,368
Other non-interest expenses	191,273	167,488
Total other operating expenses	$ 894,382	$ 670,765

NOTE 15. CAPITAL ADEQUACY

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

Quantitative measures, established by the regulators to ensure capital adequacy, require that the Bank maintain minimum ratios (set forth in the following table) of capital to risk weighted assets and average assets. Management believes that, as of December 31, 2007, the Bank met all capital adequacy requirements to which it was subject.

The most recent notification from the FDIC categorized the Bank as well-capitalized under the FDICIA regulatory framework for prompt corrective action. To be categorized as well capitalized, the institution must maintain a total risk-based capital ratio as set forth in the following table and not be subject to a capital directive order (such as a Formal Agreement). There are no conditions or events since that notification that Management believes has changed the Bank's risk-based capital category.

(Dollars in thousands)	Actual		For Capital Adequacy Purposes:		Capitalized Under the FDICIA Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2007						
Total capital (to risk weighted assets)	$ 20,646	14.10%	$ 11,714	8.00%	$ 14,643	10.00%
Tier 1 capital (to risk weighted assets)	$ 18,858	12.88%	$ 5,857	4.00%	$ 8,786	6.00%
Tier 1 capital (to average assets) leverage ratio	$ 18,858	12.27%	$ 6,148	4.00%	$ 7,685	5.00%
As of December 31, 2006						
Total capital (to risk weighted assets)	$ 19,313	17.80%	$ 8,678	8.00%	$ 10,847	10.00%
Tier 1 capital (to risk weighted assets)	$ 18,037	16.63%	$ 4,339	4.00%	$ 6,508	6.00%
Tier 1 capital (to average assets) leverage ratio	$ 18,037	14.08%	$ 5,126	4.00%	$ 6,407	5.00%

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

NOTE 16. FAIR VALUE OF FINANCIAL INSTRUMENTS

The following table presents the carrying amounts and estimated fair values of the Bank's financial instruments at December 31, 2007 and December 31, 2006. The fair value of financial instruments does not represent actual amounts that may be realized upon any sale or liquidation of the related assets or liabilities. In addition, these values do not give effect to discounts to fair value which may occur when financial instruments are sold in larger quantities. The fair values presented represent the Bank's best estimate of fair value using the methodologies discussed below.

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

	December 31, 2007		December 31, 2006	
	Amount	Value	Amount	Value
Financial Assets:				
Cash and cash equivalents	$ 13,708,754	$ 13,708,754	$ 23,907,399	$ 23,907,399
Securities available-for-sale	19,900,590	19,900,590	18,624,988	18,624,988
Securities held-to-maturity	1,048,149	1,027,970	1,264,059	1,217,421
Loans, net	117,169,433	116,934,223	81,017,571	80,897,784
Accrued interest receivable	672,218	672,218	712,627	712,627
Bank owned life insurance	3,460,653	3,460,653	3,331,971	3,331,971
serv assets				
Financial Liabilities:				
Noninterest-bearing demand deposits	$ 44,200,647	$ 44,200,647	$ 33,693,998	$ 33,693,998
Interest-bearing demand deposits	8,598,091	8,598,091	6,382,888	6,382,888
Savings and money market deposits	53,739,693	53,739,693	44,979,206	44,979,206
Time certificates of deposit	32,470,437	32,478,896	27,925,451	27,875,282
Accrued interest payable	512,511	512,511	401,544	401,544
Other liabilities	1,745,898	1,745,898	1,474,465	1,474,465

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

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

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

Loans: The fair value of fixed rate loans is determined as the present value of expected future cash flows discounted at the interest rate currently offered by the Bank, which approximates rates currently offered by local lending institutions for loans of similar terms to companies with comparable credit risk. Variable rate loans which re-price frequently with changes in approximate market rates were valued using the outstanding principal balance. The estimated fair value of loan commitments and contingent liabilities at December 31, 2007 and December 31, 2006 approximate current book values.

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

OUR BOARD OF DIRECTORS

AS PICTURED LEFT TO RIGHT:

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(Vice-Chairman)
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Hansen Insurance Company

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CPA, Partner-In-Charge
Hutchinson & Bloodgood, LLP

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President
The ATG Group

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Grunsky, Ebey, Farrar & Howell

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(Chairman)
Director of Client Relations
Scharf Investments

David V. Heald
President & CEO
Santa Cruz County Bank

SANTA CRUZ COUNTY BANK MANAGEMENT TEAM

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Frederick L. Caiocca, Executive Vice President & Chief Credit Officer
Mary Anne Carson, Senior Vice President, Director of Marketing & Community Relations
Angelo DeBernardo, Jr., Senior Vice President, Senior Lending Officer
Jim Earnhardt, Senior Vice President, IT, Operations & Facilities
Tracy Ruelas-Hashimoto, Vice President, Controller
Janice Zappa, Vice President, Corporate Secretary

SHAREHOLDER INFORMATION

Shareholders with questions regarding their stockholder account, stock transfer and registration, lost certificates or change of address should contact their broker, or if held directly, contact the Bank's stock transfer agent listed below:

Computershare Investor Services
350 Indiana Street, Suite 800
Golden, CO 80401
Phone: 800.962.4284
Internet: www.computershare.com

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

BANKING OFFICES & ATM LOCATIONS

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

SANTA CRUZ
New Location, Summer '08
720 Front St.
Santa Cruz, CA 95060
831.457.5000

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

WATSONVILLE
595 Auto Center Dr.
Watsonville, CA 95076
831.761.7600

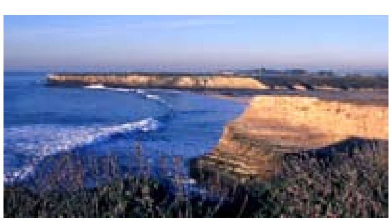
BUSINESS LENDING OFFICE

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

ATM & NIGHT DEPOSITORY LOCATIONS

SANTA CRUZ
1555 Soquel Dr.
Santa Cruz CA 95065

APTOS
783-25 Rio Del Mar Blvd.
Aptos, CA 95003



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