Annual Report
2008

Valley Community Bank

VALLEY
COMMUNITY BANK

ANNUAL REPORT 2008

In 2008, the financial services industry saw a substantial decrease in real estate values and real estate development caused, in part, by defaults on a variety of mortgages. Banks who had concentrations in first mortgage loans suffered some serious financial setbacks.

At Valley Community Bank we have never been a focused first mortgage lender so the early effects of the mortgage market collapse did not directly impact us.

During 2008 we concentrated our efforts on providing loan and deposit products to the communities we serve. As a result, we had the highest volume of loan growth in our history.

Despite the recessional effects of the mortgage industry on the economy, our plans for 2009 are to continue to provide loan and deposit products to the communities we serve like we have done since 1998.

Thanks for all of your support,

Richard P. Loupe
President and Chief Executive Officer

Phillip R. Boyce
Chairman of the Board

VALLEY COMMUNITY BANK

FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2008 AND 2007

AND FOR THE YEARS ENDED

DECEMBER 31, 2008, 2007 AND 2006

AND

INDEPENDENT AUDITOR'S REPORT

INDEPENDENT AUDITOR'S REPORT

The Shareholders and
Board of Directors
Valley Community Bank

We have audited the balance sheets of Valley Community Bank as of December 31, 2008 and 2007, and the related statements of income, changes in shareholders' equity and cash flows for each of the years in the three year period ended December 31, 2008. 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 Valley Community Bank as of December 31, 2008 and 2007, and the results of its operations and its cash flows for each of the years in the three year period ended December 31, 2008, in conformity with accounting principles generally accepted in the United States of America.

Vavrinek Trine Day + Co. LLP

Pleasanton, California
March 23, 2009

VALLEY COMMUNITY BANK

BALANCE SHEETS
DECEMBER 31, 2008 AND 2007

ASSETS	2008	2007
Cash and due from banks	$ 10,394,248	$ 7,571,866
Federal funds sold	-	15,275,000
Cash and cash equivalents	10,394,248	22,846,866
Time deposits with other financial institutions	9,097,000	2,693,000
Securities available-for-sale	6,350,687	2,748,783
Securities held-to-maturity	1,822,844	5,008,943
Federal Home Loan Bank stock	965,900	735,700
Loans, less allowance for loan losses of $3,132,073 in 2008 and $1,786,053 in 2007	172,665,005	128,219,309
Bank premises and equipment, net	545,640	655,467
Cash surrender value of life insurance policies	2,535,877	2,434,632
Accrued interest receivable and other assets	5,006,476	2,322,232
Total assets	$ 209,383,677	$ 167,664,932
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Non-interest bearing	$ 34,810,909	$ 35,559,737
Interest bearing	141,092,667	105,816,332
Total deposits	175,903,576	141,376,069
Short-term borrowings	14,000,000	6,000,000
Accrued interest payable and other liabilities	1,227,840	524,929
Total liabilities	191,131,416	147,900,998
Commitments and contingencies (Note 8)		
Shareholders' equity:		
Preferred stock - no par value; 10,000,000 shares authorized; none issued and outstanding	-	-
Common stock - no par value; 20,000,000 shares authorized; issued and outstanding - 1,854,379 and 1,793,255 shares at December 31, 2008, and 2007, respectively	16,464,203	16,084,043
Additional paid in capital	345,456	254,673
Accumulated other comprehensive income (loss), net of tax	30,381	(718)
Retained earnings	1,412,221	3,425,936
Total shareholders' equity	18,252,261	19,763,934
Total liabilities and shareholders' equity	$ 209,383,677	$ 167,664,932

The notes are an integral part of these financial statements.

VALLEY COMMUNITY BANK

STATEMENTS OF INCOME
FOR THE YEARS ENDED DECEMBER 31, 2008, 2007, AND 2006

	2008	2007	2006
Interest income:			
Interest and fees on loans	$ 11,123,527	$ 12,314,937	$ 10,872,265
Interest on Federal funds sold	103,693	582,139	236,772
Interest on investment securities	248,942	490,719	610,857
Interest on deposits with other financial institutions	182,992	76,401	34,357
Total interest income	11,659,154	13,464,196	11,754,251
Interest expense:			
Interest on deposits	2,959,627	4,310,589	3,062,644
Interest on short-term borrowings	451,161	334,099	461,236
Total interest expense	3,410,788	4,644,688	3,523,880
Net interest income before provision for loan losses	8,248,366	8,819,508	8,230,371
Provision for loan losses	5,785,000	135,000	305,000
Net interest income after provision for loan losses	2,463,366	8,684,508	7,925,371
Non-interest income:			
Service charges	344,702	203,125	193,317
Gain on sale of government guaranteed loans	707,836	628,630	98,096
Loan servicing income	259,541	113,714	101,082
Other income	300,033	238,666	172,852
Total non-interest income	1,612,112	1,184,135	565,347
Other expenses:			
Salaries and employee benefits	4,635,750	4,344,513	3,359,400
Legal expense	358,000	42,700	29,000
Occupancy and equipment	993,839	836,654	733,830
Other	1,485,903	1,142,104	1,019,305
Total other expenses	7,473,492	6,365,971	5,141,535
Income (loss) before provision for income taxes	(3,398,014)	3,502,672	3,349,183
Provision for income taxes	(1,384,299)	1,454,528	1,320,640
Net income (loss)	$ (2,013,715)	$ 2,048,144	$ 2,028,543
Basic earnings (loss) per share	$ (1.11)	$ 1.15	$ 1.14
Diluted earnings (loss) per share	$ (1.11)	$ 1.05	$ 1.05

The notes are an integral part of these financial statements.

VALLEY COMMUNITY BANK

STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2008, 2007, AND 2006

	Common Stock Shares	Common Stock Amount	Additional Paid in Capital	Comprehensive Income (Loss)	Retained Earnings	Equity
Balance, January 1, 2006	1,606,567	$ 12,547,871	$ -	$ -	$ 2,621,824	$ 15,169,695
Stock option expense			110,000			110,000
Stock options exercised and related tax benefit	9,689	138,388			-	138,388
5% stock dividend	80,495	1,589,776			(1,589,776)	-
Fractional shares					(3,170)	(3,170)
Net income				2,028,543	2,028,543	2,028,543
				$ 2,028,543		
Balance, December 31, 2006	1,696,751	14,276,035	110,000		3,057,421	17,443,456
Stock option expense			144,673			144,673
Stock options exercised and related tax benefit	11,601	131,173				131,173
5% stock dividend	84,903	1,676,835			(1,676,835)	-
Fractional shares					(2,794)	(2,794)
Unrealized loss on securities, net of tax				(718)		(718)
Net income				2,048,144	2,048,144	2,048,144
				$ 2,047,426		
Balance, December 31, 2007	1,793,255	16,084,043	254,673		3,425,936	19,763,934
Stock option expense			90,783			90,783
Stock options exercised and related tax benefit	61,124	380,160				380,160
Unrealized gain on securities, net of tax				31,099		31,099
Net loss				(2,013,715)	(2,013,715)	(2,013,715)
				$ (1,982,616)		
Balance, December 31, 2008	1,854,379	$ 16,464,203	$ 345,456		$ 1,412,221	$ 18,252,261

The notes are an integral part of these financial statements.

VALLEY COMMUNITY BANK

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2008, 2007, AND 2006

	2008	2007	2006
Cash flows from operating activities:			
Net income (loss)	$ (2,013,715)	$ 2,048,144	$ 2,028,543
Adjustments to reconcile net income (loss) to cash provided by operating activities:			
Provision for loan losses	5,785,000	135,000	305,000
Depreciation and amortization	220,011	261,250	259,540
Loss (gain) of sale of equipment	(1,200)	4,172	-
Share based compensation expense	90,783	144,673	110,000
Excess tax benefits from share-based arrangements	(28,148)	(48,402)	(29,000)
Provision for deferred taxes	(187,019)	(207,000)	(394,900)
Dividends from FHLB stock	(41,600)	(43,400)	(34,100)
(Increase) decrease in:			
Cash surrender value of life insurance policies	(101,245)	(97,319)	(60,565)
Accrued interest and other assets	(550,238)	(287,952)	643,474
Increase (decrease) in:			
Deferred loan origination fees	16,757	(53,724)	(68,643)
Accrued interest payable and other liabilities	(1,215,928)	(202,329)	(398,343)
Net cash provided by operating activities	1,973,458	1,653,113	2,361,006
Cash flows from investing activities:			
Net decrease (increase) in loans	(50,247,453)	2,532,428	(25,070,806)
Proceeds from called and matured held-to-maturity investment securities	2,500,000	8,255,891	6,087,000
Proceeds from called and matured available-for-sale investments	3,855,000	4,800,000	-
Purchase of available-for-sale investments	(7,404,000)	(7,549,921)	-
Principal repayments received from held-to-maturity mortgage-backed securities	680,726	674,198	797,339
Purchase of FHLB stock	(188,600)	-	(2,100)
Net increase in time deposits with other financial institutions	(6,404,000)	(2,693,000)	-
Purchase of life insurance policies	-	-	(857,000)
Proceeds from sale of equipment	1,200	8,800	-
Purchase of premises and equipment	(126,616)	(347,381)	(54,981)
Net cash provided (used) by investing activities	$ (57,333,743)	$ 5,681,015	$ (19,100,548)

The notes are an integral part of these financial statements.

VALLEY COMMUNITY BANK

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2008, 2007, AND 2006

	2008	2007	2006
Cash flows from financing activities:			
Net increase in demand, interest			
bearing and savings deposits	$ 10,601,984	$ 5,685,291	$ 8,000,077
Net (decrease) increase in time deposits	23,925,522	(5,358,721)	11,052,665
Proceeds from short-term borrowings	14,000,000	4,000,000	11,100,000
Repayments of short-term borrowings	(6,000,000)	(5,300,000)	(9,800,000)
Proceeds from the exercise of stock options	352,013	82,771	138,388
Excess tax benefit from share-based arrangements	28,148	48,402	29,000
Cash paid in lieu of fractional shares	-	(2,795)	(3,170)
Net cash provided (used) by financing activities	42,907,667	(845,052)	20,516,960
Increase (decrease) in cash and cash equivalents	(12,452,618)	6,489,076	3,777,418
Cash and cash equivalents at beginning of year	22,846,866	16,357,790	12,580,372
Cash and cash equivalents at end of year	$ 10,394,248	$ 22,846,866	$ 16,357,790
Supplemental disclosure of cash flow information:			
Cash paid during the year for the following:			
Interest expense	$ 3,476,137	$ 4,691,799	$ 3,292,439
Income taxes	$ 215,000	$ 1,894,000	$ 844,000
Non-cash investing activities:			
Real estate acquired through foreclosure	$ 131,892	$ -	$ -

The notes are an integral part of these financial statements.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General

Valley Community Bank (the "Bank") is a state-chartered financial institution organized under the laws of the State of California that opened for business on August 10, 1998.

The Bank engages in the general commercial banking business, to include the following: accepts checking and savings deposits; makes commercial, real estate, automobile and other installment and term loans; sells travelers' checks and provides other customary banking services, including note collection and safe deposit rental. The Bank attracts the majority of its loan and deposit business from the residents and numerous small to medium sized businesses and professional firms located in Pleasanton, Livermore, San Ramon, San Jose and nearby communities within Alameda, Contra Costa and Santa Clara Counties. The deposits of the Bank are insured by the Federal Deposit Insurance Corporation (FDIC) up to the applicable limits. The Bank conducts its operations from five branches located in Pleasanton, Livermore, San Ramon, San Jose and Santa Cruz.

The accounting and reporting policies of the Bank conform to generally accepted accounting principles and prevailing practices within the banking industry.

Reclassifications

Certain reclassifications have been made to prior years' balances to conform to classifications used in 2008.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of 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 these estimates.

Cash and Cash Equivalents

Cash and cash equivalents includes cash and due from banks and federal funds sold. Generally, federal funds sold mature the following business day.

Investment Securities

Investments are classified into one of the following categories:

- Available-for-sale securities, reported at fair value, with unrealized gains and losses excluded from earnings and reported, net of taxes, as accumulated other comprehensive income (loss) within shareholders' equity.

- Held-to-maturity securities, which management has the positive intent and ability to hold to maturity, reported at amortized cost, adjusted for the accretion of discounts and amortization of premiums.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Investment Securities (Continued)

Management determines the appropriate classification of its investments at the time of purchase and may only change the classification in certain limited circumstances. All transfers between categories are accounted for at fair value.

Gains or losses on the sale of investment securities are computed using the specific identification method. Interest earned on investment securities is reported in interest income, net of applicable adjustments for accretion of discounts and amortization of premiums.

Investment securities are evaluated for impairment at least quarterly and more frequently when economic or market conditions warrant such an evaluation to determine whether a decline in their value is other than temporary. Management utilizes criteria such as the magnitude and duration of the decline and the intent and ability of the Bank to retain its investment in the issues for a period of time sufficient to allow for an anticipated recovery in fair value, in addition to the reasons underlying the decline, to determine whether the loss in value is other than temporary. The term "other than temporary" is not intended to indicate that the decline is permanent, but indicates that the prospects for a near-term recovery of value is not necessarily favorable, or that there is a lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. Once a decline in value is determined to be other than temporary, the value of the security is reduced and a corresponding charge to earnings is recognized.

Investment in Federal Home Loan Bank Stock

In order to borrow from the Federal Home Loan Bank (FHLB), the Bank is required to maintain an investment in FHLB capital stock. The investment is carried at cost and redeemable at par.

Loans

Loans are stated at principal balances outstanding. Interest is accrued daily based upon outstanding loan balances. However, when, in the opinion of management, loans are considered to be impaired and the future collectibility of interest and principal is in serious doubt, loans are placed on nonaccrual status and the accrual of interest income is suspended. Any interest accrued but unpaid is charged against income. Payments received are applied to reduce principal to the extent necessary to ensure collection. Subsequent payments on these loans, or payments received on nonaccrual loans for which the ultimate collectibility of principal is not in doubt, are applied first to earned but unpaid interest and then to principal.

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due (including both principal and interest) in accordance with the contractual terms of the loan agreement. An impaired loan is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or, as a practical matter, at the loan's observable market price or the fair value of collateral if the loan is collateral dependent.

Loan origination fees, commitment fees, direct loan origination costs and purchase premiums and discounts on loans are deferred and recognized as an adjustment of yield, to be amortized to interest income over the contractual term of the loan. The unamortized balance of deferred fees and costs is reported as a component of net loans.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Loans (Continued)

In addition, the Bank services loans that have been participated with other financial institutions totaling approximately $2,307,159 and $2,435,158 as of December 31, 2008 and 2007, respectively. These loans were sold without recourse and, therefore, their sold balances are not included on the Bank's balance sheet.

The Bank may purchase loans or acquire loans through a business combination for which differences exist between the contractual cash flows and the cash flows expected to be collected due, at least in part, to credit quality. When the Bank acquires such loans, the yield that may be accreted (accretable yield) is limited to the excess of the Bank's estimate of undiscounted cash flows expected to be collected over the Bank's initial investment in the loan. The excess of contractual cash flows over cash flows expected to be collected may not be recognized as an adjustment to yield, loss, or a valuation allowance. Subsequent increases in cash flows expected to be collected generally should be recognized prospectively through adjustment of the loan's yield over its remaining life. Decreases in cash flows expected to be collected should be recognized as an impairment. The Bank may not "carry over" or create a valuation allowance in the initial accounting for loans acquired under these circumstances. At December 31, 2008, there were no loans being accounted for under this policy.

Allowance for Loan Losses

The allowance for loan losses is maintained to provide for losses related to impaired loans and other losses that can be expected to occur in the normal course of business. The determination of the allowance is based on estimates made by management, to include consideration of the character of the loan portfolio, specifically identified problem loans, potential losses inherent in the portfolio taken as a whole and economic conditions in the Bank's service area.

Loans determined to be impaired or classified are individually evaluated by management for specific risk of loss. In addition, reserve factors are assigned to currently performing loans based on management's assessment of the following for each identified loan type: (1) inherent credit risk, (2) historical losses and (3) where the Bank has not experienced losses, the loss experience of peer banks. Management also computed expected loss reserves for loan commitments that totaled $45,000 and $35,000 as of December 31, 2008 and 2007, respectively. These reserves are included in accrued interest payable and other liabilities on the balance sheet. These estimates are particularly susceptible to changes in the economic environment and market conditions.

The Bank's Loan Committee reviews the adequacy of the allowance for loan losses at least quarterly, to include consideration of the relative risks in the portfolio and current economic conditions. The allowance for loan losses is adjusted based on that review if, in the judgment of the Loan Committee and management, changes are warranted.

The allowance for loan losses is established through a provision for loan losses which is charged to expense. Additions to the allowance for loan losses are expected to maintain the adequacy of the allowance for loan losses after credit losses and loan growth. The allowance for loan losses at December 31, 2008 and 2007 reflects management's estimate of possible losses in the portfolio.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Other Real Estate Owned

Other real estate owned includes real estate acquired in full or partial settlement of loan obligations. When property is acquired, any excess of the Bank's recorded investment in the loan balance and accrued interest income over the estimated fair market value of the property, net of estimated selling costs, is charged against the allowance for loan losses. A valuation allowance for losses on other real estate is maintained to provide for temporary declines in value. The allowance is established through a provision for losses on other real estate which is included in other expenses. Subsequent gains or losses on sales or write-downs resulting from permanent impairments are recorded in other income or expense as incurred. On the balance sheet, other real estate owned is included in accrued interest receivable and other assets. Operating expenses of such properties, net of related income, are included in other expenses. The Bank held other real estate owned in the amount of $131,892 and $0 at December 31, 2008 and 2007, respectively.

Sales and Servicing of Government Guaranteed Loans

Included in the portfolio are loans which, in general, are 75 percent or 85 percent guaranteed by the Small Business Administration and loans which, in general, are 60 percent to 80 percent guaranteed under the Business and Industry (B&I) Guaranteed Loan Program. Loans held for sale are carried at the lower of cost or market value. Market value is determined by the specific identification method as of the balance sheet date or the date on which a third party has committed to purchase the loans. The guaranteed portion of these loans may be sold to a third party, with the Bank retaining the unguaranteed portion. The Bank generally receives a premium in excess of the adjusted carrying value of the loan at the time of sale. The Bank may be required to refund a portion of the sales premium if the borrower defaults or the loan prepays within ninety days of the settlement date. The Bank had received premiums of approximately $36,000, $139,000 and $31,000 at December 31, 2008, 2007 and 2006, which were subject to these recourse provisions. The guaranteed portion of SBA and B&I loans, totaling approximately $37,701,000, and $18,111,000, was being serviced for others at December 31, 2008 and 2007, respectively.

Sales of loans are recognized when the transferred loans are put beyond the reach of the Bank and its creditors, even in receivership. Servicing rights acquired through 1) a purchase or 2) the origination of loans which are sold with servicing rights retained are recognized as separate assets or liabilities. Servicing assets or liabilities are recorded at the difference between the contractual servicing fees and adequate compensation for performing the servicing, and are subsequently amortized in proportion to and over the period of the related net servicing income or expense. Servicing assets are periodically evaluated for impairment. Fair values are estimated using discounted cash flows based on current market interest rates. For purposes of measuring impairment, servicing assets are stratified based on note rate and term. The amount of impairment recognized is the amount by which the servicing assets for a stratum exceed their fair value. When management deems there to be impairment of the servicing asset, a write-down is charged to a valuation allowance. On the balance sheet, servicing assets are included in accrued interest receivable and other assets.

In addition, assets (accounted for as interest-only (IO) strips) are recorded at the fair value of the difference between note rates and rates paid to purchasers (the interest spread) and contractual servicing fees, if applicable. IO strips are carried at fair value with gains or losses recorded as a component of shareholders' equity, similar to available-for-sale investment securities. IO strips were not material at December 31, 2008 and 2007 and have been included in servicing assets.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Sales and Servicing of Government Guaranteed Loans (Continued)

The Bank's investment in the loan is allocated between the retained portion of the loan, the servicing asset, the IO strip, and the sold portion of the loan based on their relative fair values on the date the loan is sold. The gain on the sold portion of the loan is recognized as income at the time of sale. The carrying value of the retained portion of the loan is discounted based on the estimated yield of a comparable non-guaranteed loan. Significant future prepayments of these loans will result in the recognition of additional amortization of related servicing assets and an adjustment to the carrying value of related IO strips.

Bank Premises and Equipment

Bank premises and equipment are carried at cost. Depreciation is determined using the straight-line method over the estimated useful lives of the related assets. The useful lives of furniture, fixtures, and equipment are estimated to be three to seven years. Leasehold improvements are amortized over the life of the asset or the term of the related lease, whichever is shorter. The leasehold interest is amortized over the underlying lease term, including option renewal periods. When assets are sold or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts, and any resulting gain or loss is recognized in income for the period. The cost of maintenance and repairs is charged to expense as incurred.

Cash Surrender Value of Life Insurance

The Bank accounts for its investment in life insurance policies at the amount that could be realized under the insurance contract.

Income Taxes

Deferred tax assets and liabilities are recognized for the tax consequences of temporary differences between the financial statement and tax bases of existing assets and liabilities. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment. A valuation allowance is recognized if, based on the weight of available evidence, management believes it is more likely than not that some portion or all of the deferred tax asset will not be realized. Realization of tax benefits of deductible temporary differences and operating loss carryforwards depend on having sufficient taxable income of an appropriate character within the carryforward period. On the balance sheet, net deferred tax assets are included in accrued interest receivable and other assets.

The Bank has adopted 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 operating expense/income tax expense.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Earnings (Loss) Per Share

Basic earnings (loss) per share (EPS), which excludes dilution, is computed by dividing income available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock, such as stock options, result in the issuance of common stock which shares in the earnings of the Bank. The treasury stock method is applied to determine the dilutive effect of stock options in computing diluted EPS. Earnings per share are retroactively adjusted for stock dividends and stock splits for all periods presented.

Recently Issued Accounting Pronouncements

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

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 159 permits an entity to choose to measure many financial instruments and certain other items at fair value. Most of the provisions of SFAS 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 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. The Bank did not elect the fair value option for any financial assets or financial liabilities as of January 1, 2008.

In September 2006, the FASB Emerging Issues Task Force finalized Issue No. 06-4, *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements*. This issue requires that a liability be recorded during the service period when a split-dollar life insurance agreement continues after participants' employment or retirement. The required accrued liability will be based on either the post-employment benefit cost for the continuing life insurance or based on the future death benefit depending on the contractual terms of the underlying agreement. This issue was effective for fiscal years beginning after December 15, 2007. The impact of adoption was not material.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements* – an amendment of ARB No. 51, which will change the accounting and reporting for minority interest, which will be recharacterized as noncontrolling interest and classified as a component of equity within the consolidated balance sheets. SFAS No. 160 is effective as of beginning of the first fiscal year beginning on or after December 15, 2008. Earlier adoption is prohibited. The Bank does not expect the adoption of SFAS No. 160 to have a significant impact on its results of operations or financial position.

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

NOTE 2 - INVESTMENT SECURITIES

The amortized cost and estimated fair value of investment securities at December 31, 2008 and 2007, consisted of the following:

	2008			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Held-to-Maturity Debt Securities:				
Mortgage-backed securities	$ 1,822,844	$ 5,552	$ (4,882)	$ 1,823,514
Available-for-Sale Debt Securities:				
U.S. Government agencies	$ 6,299,194	$ 51,493	$ -	$ 6,350,687

	2007			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Held-to-Maturity Debt Securities:				
U.S. Government agencies	$ 2,497,078	$ -	$ (19,278)	$ 2,477,800
Mortgage-backed securities	2,511,865	-	(44,426)	2,467,439
	$ 5,008,943	$ -	$ (63,704)	$ 4,945,239
Available-for-Sale Debt Securities:				
U.S. Government agencies	$ 2,750,000	$ -	$ (1,217)	$ 2,748,783

There were no sales or transfers of held-to-maturity investment securities for the years ended December 31, 2008 and 2007.

Investment securities with unrealized losses at December 31, 2008, are summarized and classified according to the duration of the loss period as follows:

	Less than 12 months		12 Months or More		Total	
	Estimated Fair Value	Unrealized Losses	Estimate Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
Held-to-maturity:						
Mortgage-backed securities	$ -	$ -	$ 1,018,884	$ (4,882)	$ 1,018,884	$ (4,882)
	$ -	$ -	$ 1,018,884	$ (4,882)	$ 1,018,884	$ (4,882)

At December 31, 2008, the Bank held 50 investment securities of which none were in a loss position for less than twelve months and 18 were in a loss position and had been in a loss position for twelve months or more.

NOTE 2 - INVESTMENT SECURITIES (CONTINUED)

Investment securities with unrealized losses at December 31, 2007, are summarized and classified according to the duration of the loss period as follows:

	Less than 12 months		12 Months or More		Total	
	Estimated Fair Value	Unrealized Losses	Estimate Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
Held-to-maturity:						
U.S. Government agencies	$ -	$ -	$ 2,477,800	$ (19,278)	$ 2,477,800	$ (19,278)
Mortgage-backed securities	-	-	2,467,439	(44,426)	2,467,439	(44,426)
	-	-	4,945,239	(63,704)	4,945,239	(63,704)
Available-for-sale:						
U.S. Government agencies	2,748,783	(1,217)	-	-	2,748,783	(1,217)
	$ 2,748,783	$ (1,217)	$ 4,945,239	$ (63,704)	$ 7,694,022	$ (64,921)

At December 31, 2007, the Bank held 49 investment securities of which 8 were in a loss position for less than twelve months and 41 were in a loss position and had been in a loss position for twelve months or more.

Management periodically evaluates each investment security for other than temporary impairment, relying primarily on industry analyst reports and observation of market conditions and interest rate fluctuations. Management believes it will be able to collect all amounts due according to the contractual terms of the underlying investment securities and that the noted decline in fair value is considered temporary and due only to interest rate fluctuations.

The amortized cost and estimated fair value of held-to-maturity investment securities at December 31, 2008, by contractual maturity are shown below. Mortgage-backed securities are excluded from the table below because they are not due at a single maturity date but are generally repaid monthly over the life of the underlying mortgage loans. Expected maturities may differ from contractual maturities because borrowers may have the right to call or repay obligations with or without call or prepayment penalties.

	Held-to-maturity		Available-for-sale	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due within one year	$ 412,181	$ 411,652	$ 1,400,000	$ 1,406,247
Due after one year through five years	1,410,663	1,411,862	4,899,194	4,944,440
	$ 1,822,844	$ 1,823,514	$ 6,299,194	$ 6,350,687

At December 31, 2008 and 2007, all held-to-maturity and available-for-sale investment securities were pledged to secure borrowing arrangements with the Federal Reserve Bank and Federal Home Loan Bank (see Note 6).

NOTE 3 - LOANS

Outstanding loans are summarized below:

	December 31,	
	2008	2007
Commercial	$ 64,762,530	$ 46,096,792
Real estate - mortgage	81,969,076	61,780,887
Real estate - land and construction	28,889,320	21,998,876
Consumer	208,431	144,329
	175,829,357	130,020,884
Deferred loan origination fees, net	(32,279)	(15,522)
Allowance for loan losses	(3,132,073)	(1,786,053)
	$ 172,665,005	$ 128,219,309

Changes in the allowance for loan losses for the years ended December 31, 2008, 2007, and 2006 were as follows:

	2008	2007	2006
Balance, beginning of year	$ 1,786,053	$ 1,854,835	$ 1,473,365
Provisions charged to operations	5,785,000	135,000	305,000
Loans charged off	(4,442,631)	(222,425)	(25,116)
Recoveries	3,651	18,643	101,586
Balance, end of year	$ 3,132,073	$ 1,786,053	$ 1,854,835

For the 2008 fiscal year, both 1) the total loan loss provision charged to operations of $5,785,000 and 2) total loans charged off of $4,442,631, were impacted by the write-off of one non-real estate related loan in the amount of $4.2 million.

The recorded investment in loans that were considered to be impaired totaled $1,288,000 and $144,000 at December 31, 2008 and 2007, respectively. The related allowance for loan losses for these loans as determined under loan impairment standards at December 31, 2008 and 2007 totaled $233,000 and $36,000, respectively. The average recorded investment in impaired loans for the years ended December 31, 2008, 2007 and 2006 totaled $647,000, $180,000, and $228,000, respectively. No interest income was recognized on impaired loans during the years ended December 31, 2008, 2007 and 2006.

Loans on nonaccrual status at December 31, 2008 and 2007 totaled $493,000 and $144,000, respectively. Interest foregone on nonaccrual loans was $32,000, $22,000 and $61,000 for the years ended December 31, 2008, 2007 and 2006, respectively. Salaries and employee benefits totaling $358,000, $265,000, and $297,000 were deferred as loan origination costs for the years ended December 31, 2008, 2007 and 2006, respectively.

Loans with fair values of approximately $41,704,000 and $40,529,000 were pledged to secure borrowing arrangements at December 31, 2008 and 2007, respectively (see Note 6).

NOTE 3 – LOANS (CONTINUED)

Sales and Servicing of Government Guaranteed Loans

The Bank adopted SFAS 156 effective January 1, 2007. The Bank identified servicing assets relating to all existing SBA loans as a class of servicing rights and elected to apply the amortization method of accounting to these servicing assets. In accordance with SFAS 156, servicing assets are initially recorded at fair value. The Bank generally estimates fair value based on the present value of future expected cash flows estimated using management's best estimates of the key assumptions that include prepayment speeds and discount rates commensurate with the risks involved.

The servicing asset represents the value of the contractual servicing fee less adequate servicing compensation. Adequate servicing compensation in the SBA industry has been considered 40 basis points. Therefore, the servicing asset value is based upon the contractual servicing fee of generally 1% less adequate servicing compensation of 40 basis points. When the interest rate retained exceeds the contractual servicing fee, the excess is considered the interest-only strip receivable. The balance of interest-only strip receivable is not material and has been included in the servicing asset. No impairment gains or losses were recognized. Servicing assets are included in accrued interest receivable and other assets on the balance sheet.

At December 31, 2008 and 2007, the unpaid principal balance of SBA and B&I loans serviced for others totaled $37,701,000 and $18,111,000, respectively. The gain on sale of SBA and B&I loans was $707,836, $1,117,605, and $108,500 for the years ended December 31, 2008, 2007, and 2006, respectively.

Servicing income is a component of non interest income in the statement of income. The Bank recognized $365,000, $114,000 and $101,000 in servicing fees for the years ended December 31, 2008, 2007 and 2006, respectively.

Following is an analysis of activity in servicing assets:

	December 31, 2008	December 31, 2007
Carrying amount, beginning of year	$ 352,022	$ 142,651
Additions:		
Assumption of servicing obligations	1,826,208	263,599
Subtractions:		
Amortization	(1,551,550)	(54,228)
Carrying amount, before valuation allowance	626,680	352,022
Valuation allowance	-	-
Carrying amount, end of year	$ 626,680	$ 352,022

NOTE 4 - BANK PREMISES AND EQUIPMENT

Bank premises and equipment consisted of the following:

	December 31, 2008	December 31, 2007
Leasehold improvements	$ 1,022,779	$ 969,393
Leasehold interest	193,000	193,000
Furniture and equipment	1,209,844	1,160,027
Construction in progress	5,303	-
	2,430,926	2,322,420
Less accumulated depreciation and amortization	(1,885,286)	(1,666,953)
	$ 545,640	$ 655,467

Depreciation and amortization included in occupancy and equipment expense totaled $236,000, $253,000 and $250,000 for the years ended December 31, 2008, 2007 and 2006, respectively.

NOTE 5 - INTEREST-BEARING DEPOSITS

Interest-bearing deposits consisted of the following:

	December 31, 2008	December 31, 2007
Savings	$ 2,361,633	$ 2,136,189
Money market	58,058,537	44,904,295
NOW accounts	7,207,885	9,236,758
Time, $100,000 or more	26,545,106	28,419,468
Other time	46,919,506	21,119,622
Total	$ 141,092,667	$ 105,816,332

Aggregate annual maturities of time deposits are as follows:

Year Ending December 31, 2008	2008
2009	$ 72,135,616
2010	1,328,996
	$ 73,464,612

NOTE 5 - INTEREST-BEARING DEPOSITS (CONTINUED)

Interest expense recognized on interest-bearing deposits for the years ended December 31, 2008, 2007 and 2006 consisted of the following:

	2008	2007	2006
Savings	$ 19,555	$ 50,350	$ 24,266
Money market	918,498	1,534,805	1,092,274
NOW accounts	19,522	28,370	25,023
Time, $100,000 or more	1,053,166	1,750,870	1,192,569
Other time	948,886	946,194	728,512
Total	$ 2,959,627	$ 4,310,589	$ 3,062,644

NOTE 6 - BORROWING ARRANGEMENTS

The Bank may borrow up to $3,000,000 overnight on an unsecured basis from one of its correspondent banks. The Bank can also borrow up to $2,750,000 on an overnight basis from the Federal Reserve Bank, secured by investments with amortized costs and estimated market values totaling $2,749,475 and $2,762,842 (see Note 2). There were no amounts outstanding under either of these borrowing arrangements at December 31, 2008 and 2007.

At December 31, 2008, the Bank could borrow up to $26,236,000 from the FHLB on either a short-term or long-term basis, secured by investment securities with amortized costs and estimated market values totaling $6,299,000 and $6,351,000, respectively, and loans with fair values, as calculated by FHLB, totaling approximately $41,126,000 (see Notes 2 and 3).

Four advances totaling $14,000,000 were outstanding from the FHLB at December 31, 2008, bearing interest rates of 5.02%, 3.3%, 2.77%, and 2.28% with maturity dates of August 13, 2009, July 23, 2009, June 6, 2009, and March 31, 2009, respectively. Three advances totaling $6,000,000 were outstanding from the FHLB at December 31, 2007, bearing interest rates of 3.3%, 5.02%, and 5.11% with maturity dates of January 2, 2008, August 13, 2009, March 6, 2008, respectively.

NOTE 7 - INCOME TAXES

The provision (credit) for income taxes for the years ended December 31, 2008, 2007 and 2006 consisted of the following:

	2008	2007	2006
Current:			
Federal	$ (1,187,300)	$ 1,230,500	$ 1,285,900
State	-	431,000	429,600
Total current	(1,187,300)	1,661,500	1,715,500
Deferred:			
Federal	168,000	(156,000)	(328,900)
State	(365,000)	(51,000)	(66,000)
Total deferred	(197,000)	(207,000)	(394,900)
Provision (credit) for income taxes	$ (1,384,300)	$ 1,454,500	$ 1,320,600

Deferred tax assets (liabilities) at December 31, 2008 and 2007, consisted of the following:

		December 31,	
	2008	2007	2006
Deferred tax assets:			
Allowance for loan losses	$ 828,000	$ 697,000	$ 684,000
Bank premises and equipment	207,000	164,000	65,000
Deferred compensation	255,000	183,000	119,000
Future benefit of state deferred tax liabilities	-	130,000	142,000
Other	456,000	197,000	181,000
Total deferred tax assets	1,746,000	1,371,000	1,191,000
Deferred tax liabilities:			
Servicing asset	(258,000)	(145,000)	(47,000)
Deferred loan costs	(189,000)	(141,000)	(59,000)
FHLB stock dividends	(66,000)	(49,000)	(137,000)
Other	(21,000)	-	(32,000)
Total deferred tax liabilities	(534,000)	(335,000)	(275,000)
Net deferred tax assets	$ 1,212,000	$ 1,036,000	$ 916,000

NOTE 7 - INCOME TAXES (CONTINUED)

The provision for income taxes differs from amounts computed by applying the statutory Federal and State income tax rates to operating income before income taxes. The significant items comprising these differences for the years ended December 31, 2008, 2007 and 2006 consisted of the following:

	2008		2007		2006	
	Amount	Rate %	Amount	Rate %	Amount	Rate %
Federal income tax expense (credit), at statutory rate	$ (1,155,000)	(34.00)	$ 1,191,000	34.00	$ 1,139,000	34.00
State franchise tax expense, net of Federal tax effect	(243,000)	(7.20)	251,000	7.20	240,000	7.20
Net increase in cash surrender value of life insurance	(48,600)	(1.40)	(47,000)	(1.30)	(29,000)	(0.90)
Other	62,300	1.60	59,528	1.70	(29,360)	(0.80)
Total income tax expense	$ (1,384,300)	(41.00)	$ 1,454,528	41.60	$ 1,320,640	39.50

The net operating loss that the Bank suffered in 2008 will be carried back to the five years preceding the loss year for federal tax purposes. The net operating loss carryforward of $3,242,477 for state tax purposes will expire in December 2029.

The Bank is subject to federal income tax and income tax of the state of California. Our federal income tax returns for the years ended December 31, 2007, 2006 and 2005 are open to audit by the federal authorities and our California state tax returns for the years ended December 31, 2007, 2006, 2005 and 2004, are open to audit by state authorities.

We record interest and penalties related to uncertain tax positions as part of operating expense. There was no penalty or interest expense recorded as of December 31, 2008. We do not expect the total amount of unrecognized tax benefits to significantly increase or decrease within the next twelve months.

NOTE 8 - COMMITMENTS AND CONTINGENCIES

Operating Leases

The Bank leases its branch offices and various equipment under noncancelable operating leases expiring on various dates through the year 2013. The Bank has subleased a portion of its Pleasanton office space under a non-cancelable agreement that expires in 2012. Future minimum lease payments and sublease rental income are as follows:

NOTE 8 - COMMITMENTS AND CONTINGENCIES (CONTINUED)

Year Ending December 31,	Minimum Lease Payments	Minimum Sublease Rental Income
2009	$ 522,149	$ 62,544
2010	446,443	64,536
2011	452,481	66,336
2012	439,025	68,328
2013	54,147	-
	$ 1,914,245	$ 261,744

The Bank renewed its Pleasanton, Livermore and San Ramon office leases for terms of five years after the initial leases ended December 31, 2002, July 31, 2004, and July 31, 2008, respectively. In addition, the Bank purchased certain equipment at the end of its lease on July 31, 2003. Rental expense included in occupancy and equipment expense, net of related rental income, totaled $464,000, $355,000 and $265,000 for the years ended December 31, 2008, 2007 and 2006, respectively.

Federal Reserve Requirements

Banks are required to maintain reserves with the Federal Reserve Bank equal to a percentage of their reservable deposits. At December 31, 2008 and 2007, the Bank's cash balances were sufficient to comply with this reserve requirement and, therefore, no such reserve balances were held with the Federal Reserve Bank.

Correspondent Banking Agreements

The Bank maintains funds on deposit with the Federal Home Loan Bank and other federally insured institutions under correspondent banking agreements. Uninsured deposits totaled approximately $2,060,000 at December 31, 2008.

Financial Instruments with Off-Balance-Sheet Risk

The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business in order to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments consist of commitments to extend credit and letters of credit and involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized on the balance sheet.

The Bank's exposure to credit loss in the event of nonperformance by the other party for commitments to extend credit and letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and letters of credit as it does for loans included on the balance sheet.

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 some of the commitments are expected to expire without

NOTE 8 - COMMITMENTS AND CONTINGENCIES (CONTINUED)

being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Management evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies, but may include accounts receivable, inventory, and deeds of trust on residential real estate and income producing commercial properties.

Standby letters of credit are conditional commitments to guarantee the performance or financial obligation of a customer to a third party. The credit risk involved in issuing standby letters of credit is essentially the same as that involved in extending loans to customers. The fair value of the liability related to these standby letters of credit, which represents the fees received for issuing the guarantees, was not significant at December 31, 2008 and 2007. The Bank recognizes these fees as revenue over the term of the commitment or when the commitment is used.

The following financial instruments represent off-balance-sheet credit risk:

	December 31, 2008	December 31, 2007
Commitments to extend credit:		
Revolving lines of credit secured by 1-4 family residence	$ 10,281,000	$ 10,870,000
Commercial real estate, construction and land development commitments secured by real estate	13,562,000	8,430,000
Other unused commitments, comprised primarily of commercial and consumer loans secured by collateral other than real estate or unsecured	22,738,000	21,587,000
	$ 46,581,000	$ 40,887,000
Standby letters of credit	$ 1,119,000	$ 519,000

Concentrations of Credit Risk

The Bank grants real estate mortgage, real estate construction, commercial, and consumer loans to customers in Alameda, Contra Costa, and Santa Clara counties. Although the Bank has a diversified loan portfolio, a substantial portion of its portfolio is secured by commercial and residential real estate. However, personal and business income represents the primary source of repayment for a majority of these loans. As of December 31, 2008 and 2007, approximately 64% and 69%, respectively, of total loans were real estate related.

Although management believes the loans within these concentrations have no more than the normal risk of collectibility, a substantial decline in the performance of the economy in general or a decline in real estate values in the Bank's primary market area, in particular, could have an adverse impact on collectibility.

Contingencies

The Bank is subject to legal proceedings and claims which arise in the ordinary course of business. In the opinion of management, the amount of liability with respect to such actions will not materially affect the

NOTE 8 - COMMITMENTS AND CONTINGENCIES (CONTINUED)

financial position or results of operations of the Bank.

NOTE 9 - SHAREHOLDERS' EQUITY

Dividends

The California Financial Code restricts the total dividend payment of any bank in any calendar year to the lesser of (1) the bank's retained earnings or (2) the bank's net income for its last three fiscal years, less distributions made to shareholders during the same three-year period. At December 31, 2008, the Bank had $0 in retained earnings available for dividends to shareholders.

In 2007 and 2006, the Bank declared a 5% stock dividend. No dividend was declared in 2008.

Earnings (Loss) Per Share

The reconciliation of the numerators and denominators of the basic and diluted earnings (loss) per share computations are as follows:

December 31, 2008	Net Income	Weighted Average Number of Shares Outstanding	Per Share Amount
Basic (loss) per share	$ (2,013,715)	1,808,016	$ (1.11)
Effect of dilutive stock options	-	-	
Diluted (loss) per share	$ (2,013,715)	1,808,016	$ (1.11)
December 31, 2007			
Basic earnings per share	$ 2,048,144	1,788,022	$ 1.15
Effect of dilutive stock options	-	153,477	
Diluted earning per share	$ 2,048,144	1,941,499	$ 1.05
December 31, 2006			
Basic earnings per share	$ 2,028,543	1,777,385	$ 1.14
Effect of dilutive stock options	-	161,059	
Diluted earning per share	$ 2,028,543	1,938,444	$ 1.05

NOTE 10 - STOCK OPTIONS

On January 1, 2006, the Bank adopted the provisions of SFAS No. 123R *Share Based Payment* (SFAS No. 123R) requiring the measurement and recognition of all share-based compensation under the fair value method. Prior to January 1, 2006, the Bank accounted for share-based awards under APB No. 25. The Bank adopted SFAS No. 123R using the modified prospective transition method, therefore, prior period results are not restated and do not reflect the recognition of share-based compensation.

NOTE 10 – STOCK OPTIONS (CONTINUED)

Under the modified prospective transition method, share-based compensation expense is recorded for all awards granted after the adoption date and for the unvested portion of previously granted awards outstanding on the adoption date. Compensation cost related to the unvested portion of previously granted awards is based on the grant-date fair value estimated in accordance with the original provisions of SFAS No. 123. Compensation cost for awards granted after the adoption date is based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123R. Total compensation costs recorded during the year ended December 31, 2008, 2007 and 2006, amounted to $91,000, $145,000 and $110,000, respectively, and the related tax benefit was $17,000, $37,000 and $19,000, respectively.

On October 22, 1998 and January 21, 1999, respectively, the Board of Directors adopted the Valley Community Bank 1998 Employee Stock Option Plan (the "Employee Plan") and the Valley Community Bank 1998 Directors' Stock Option Plan (the "Directors' Plan"). Both plans were approved at the 1999 shareholders meeting. In 2004, the Board of Directors approved an amendment to the 1998 Employee Stock Option Plan, which was approved by the shareholders, to reserve 138,443 additional shares. In 2005, the Board of Directors approved the transfer of 48,000 shares from shares reserved under the Employee Plan to shares reserved under the Director's Plan. Under the Employee Plan at December 31, 2008, 11,300 shares of common stock are reserved for issuance to employees under incentive agreements. Under the Directors' Plan at December 31, 2008, 4,770 shares of common stock are reserved for issuance to non-employee directors. The plans require that the option price may not be less than the fair market value of the stock at the date the option is granted, and that the stock must be paid for in full at the time the option is exercised. All options expire on a date determined by the Board of Directors, but not later than ten years from the date of grant. The options vest ratably over a three year period, beginning one year from the date of grant.

The fair value of each option award is estimated on the date of grant using the Black Scholes option pricing model. Expected volatility is based on historical volatility of the common stock. The Bank uses historical data to estimate option exercise and forfeiture rates within the valuation model. The expected life of the options granted is derived from the award's vesting period and the award recipient's exercise history, if applicable, and represents the period of time that the options are expected to be outstanding. The risk-free rate for periods within the expected life of the option is based on the U.S. Treasury note rate at the time of the grant corresponding to the expected life. The assumptions used for determining the fair value of the options granted during the year ended December 31, 2008, 2007, and 2006 are as follows:

	2008	2007	2006
Expected volatility	35.87%	28.00%	28.00%
Expected dividends	None	None	None
Expected term	5 years	5 years	5 years
Risk-free rate	2.86%	4.61%	4.32%

NOTE 10 - STOCK OPTIONS (CONTINUED)

A summary of option activity of the Bank's fixed stock option plan is presented below.

	Shares	Weighted average exercise price	Weighted average remaining contractual term in years	Weighted average intrinsic value using end of period market price	Aggregate intrinsic value using end of period market price
Outstanding, January 1, 2008	457,466	$ 8.88	4.28	$ 13.50	$ 4,957,038
Exercised	(61,124)	5.76			
Forfeited	(3,756)	15.38			
Granted	3,000	7.78			
Outstanding, December 31, 2008	395,586	9.29	3.80	6.00	688,032
Excercisable, December 31, 2008	375,954	8.95	3.57	0.18	21,166

The weighted-average grant-date fair value of options granted during the year ended December 31, 2008 and 2007 was $2.82 and $5.86, respectively. The total intrinsic value of options exercised during the year ended December 31, 2008 and 2007, was $195,800 and $76,000, respectively.

Cash received from options exercised under the Plan for the years ended December 31, 2008 and 2007, was $352,000 and $83,000, respectively. The actual tax benefit realized for the tax deductions from options exercised was $28,000 and $48,000 for the years ended December 31, 2008 and 2007, respectively.

As of December 31, 2008, there was $65,000 of total unrecognized compensation cost related to nonvested share-based compensation arrangements granted under the Plan. That cost is expected to be recognized over a weighted-average period of 2.61 years.

NOTE 11 – REGULATORY CAPITAL

The Bank is subject to certain regulatory capital requirements administered by the Federal Deposit Insurance Corporation (FDIC). Failure to meet these 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 of total and Tier 1 capital to risk-weighted assets and of Tier 1 capital to average assets. Each of these components is defined in the regulations. Management believes that the Bank met all its capital adequacy requirements as of December 31, 2008 and 2007.

NOTE 11 – REGULATORY CAPITAL (CONTINUED)

In addition, the most recent notification from the FDIC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth below. There are no conditions or events since that notification that management believes have changed the Bank's category.

Regulatory capital ratios and requirements are detailed as follows:

	December 31,			
	2008		2007	
	Amount	Ratio	Amount	Ratio
Leverage Ratio				
Tier 1 Capital to Average Assets	$ 18,222,000	8.7%	$ 19,764,000	11.3%
Minimum requirement for "Well-Capitalized" institution	10,502,000	5.0%	8,723,000	5.0%
Minimum regulatory requirement	8,402,000	4.0%	6,978,000	4.0%
Tier Risk-Based Capital Ratio				
Tier 1 Capital to Risk Weighted Assets	18,222,000	9.6%	19,764,000	13.6%
Minimum requirement for "Well-Capitalized" institution	11,388,000	6.0%	8,692,000	6.0%
Minimum regulatory requirement	7,592,000	4.0%	5,794,000	4.0%
Total Risk-Based Capital Ratio				
Total Capital to Risk Weighted Assets	20,594,000	10.9%	21,575,000	14.9%
Minimum requirement for "Well-Capitalized" institution	18,980,000	10.0%	14,487,000	10.0%
Minimum regulatory requirement	15,184,000	8.0%	11,589,000	8.0%

NOTE 12 – RELATED PARTY TRANSACTIONS

During the normal course of business, the Bank enters into transactions with related parties, including Directors and executive officers. These transactions include borrowings from the Bank with substantially the same terms, including rates and collateral, as loans to unrelated parties. The following is a summary of the aggregate activity involving related party borrowers during 2008:

NOTE 12 – RELATED PARTY TRANSACTIONS (CONTINUED)

Balance, January 1, 2008	$	2,837,872
Disbursement		2,050,289
Amounts paid		(1,560,976)
Balance, December 31, 2008	$	3,327,185
Undisbursed commitments to related parties, December 31, 2008	$	2,460,517

Deposits with related parties totaled $1,512,000 and $3,552,000 at December 31, 2008 and 2007, respectively.

During 2007, the Bank entered into a lease agreement with a member of the Board of Directors. Rental payments under this agreement totaled approximately $92,000 and $78,000 for the years ended December 31, 2008 and 2007, respectively.

NOTE 13 – OTHER EXPENSES

Other expenses for the years ended December 31, 2008, 2007, and 2006 consisted of the following:

	2008	2007	2006
Data processing	$ 411,759	$ 358,882	$ 302,835
Professional fees	156,384	106,839	108,540
Advertising promotion	31,009	34,578	55,672
Office supplies	110,694	89,106	86,280
Insurance	20,557	23,756	25,583
Amortization of servicing asset	42,079	54,228	65,437
Other	713,421	474,715	374,958
	$ 1,485,903	$ 1,142,104	$ 1,019,305

NOTE 14 – EMPLOYEE BENEFIT PLANS

401 (k) Savings Plan

In August 1998, the Bank adopted a 401(k) savings plan covering substantially all employees of the Bank. Under the provisions of the plan, participants may contribute up to 15% of their pretax income. The Bank matches fifty percent of the employee's contribution up to 3% of their pretax income. Employees vest in the matching contribution over three years beginning in the second year of service. The Bank contributed $63,500, $29,700 and $29,600 to the 401(k) plan on behalf of employees for the years ended December 31, 2008, 2007 and 2006, respectively.

Salary Continuation Agreements

In 2003, the Bank implemented salary continuation agreements for three key executives. Under these agreements, the Bank is obligated to provide the executives, or their designated beneficiaries, with annual

NOTE 14 – EMPLOYEE BENEFIT PLANS (CONTINUED)

benefits for fifteen years after retirement or death. These benefits are substantially equivalent to those available under insurance policies purchased by the Bank on the lives of the executives. The estimated present value of these future benefits are accrued over the period from the effective date of the agreement until the executive's expected retirement date.

The expense recognized under these agreements totaled $176,000, $155,000 and $87,000 for the years ended December 31, 2008, 2007 and 2006, respectively, and is included in salaries and employee benefits expense in the statement of income.

In connection with these agreements, the Bank invested in single premium life insurance policies with cash surrender values totaling $2,536,000 and $2,435,000 at December 31, 2008 and 2007, respectively. Income from these policies, net of expense, totaled $101,000, $97,000 and $60,000 for the years ended December 31, 2008, 2007 and 2006, respectively, and is included as other non-interest income in the statement of income.

NOTE 15 - DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS

As discussed in Note 1 above, the Bank adopted SFAS 157 on January 1, 2008. SFAS 157 defines fair value, establishes a framework for measuring fair value under U.S. GAAP and expands disclosures about fair value measurements. SFAS 157 applies whenever other accounting pronouncements require or permit assets or liabilities to be measured at fair value. SFAS 157 does not expand the use of fair value in any new circumstances.

Under SFAS 157, fair value is a market-based measurement and defined as the price that would be received for selling an asset or paid for transferring a liability in an orderly transaction between market participants at the measurement date. The transaction to sell the asset or transfer the liability is a hypothetical transaction at the measurement date, considered from the perspective of a market participant that holds the asset or owes the liability. In general, the transaction price will equal the exit price and, therefore, represent the fair value of the asset or liability at initial recognition. In determining whether a transaction price represents the fair value of the asset or liability at initial recognition, each reporting entity is required to consider factors specific to the asset or liability, the principal or most advantageous market for the asset or liability, and market participants wit whom the entity would transact in the market.

Fair Value Hierarchy

SFAS 157 established a fair value hierarchy to prioritize the inputs of the valuation techniques used to measure fair value. The inputs are evaluated and an overall level for the measurement is determined. This overall level is an indication of how market observable the fair value measurement is and defines the level of disclosure. SFAS 157 clarifies fair value in terms of the price in an orderly transaction between market participants to sell an asset or transfer a liability in the principal (or most advantageous) market for the asset or liability. The objective of a fair value measurement is to determine the price that would e received to sell the asset or paid to transfer the liability at the measurement date (an exit price). In order to determine the fair value, entities must determine the unit of account, highest and best use, principal market, and market participants. These determinations allow the reporting entity to define the inputs for fair value and level of hierarchy.

NOTE 15 - DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

To increase consistency and comparability in fair value measures, the fair value measures, the fair value hierarchy prioritizes the inputs used in valuation techniques to measure fair value into three broad levels:

- Level 1 – quoted prices in active markets for identical assets or liabilities
- Level 2 – directly or indirectly observable inputs other than quoted prices, and
- Level 3 – unobservable inputs.

A financial instrument's categorization within the fair value hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The Bank categories available for sale securities as level 2 because the inputs to the valuation methodology used to measure the fair value of these securities include quoted prices for similar assets in active markets, and inputs that are observable for the asset, either directly or indirectly, for substantially the full term of the financial instrument.

Fair Value on a Recurring Basis

The following table presents for each SFAS 157 hierarchy level the financial assets and liabilities that are measured at fair value on a recurring basis on the Balance Sheet as of December 31, 2008.

	As of December 31, 2008			
Fair Value Hierarchy	**Total**	**Level 1**	**Level 2**	**Level 3**
Available For Sale Securities	$ 6,350,687	$ -	$ 6,350,687	$ -
Total assets at fair value	$ 6,350,687	$ -	$ 6,350,687	$ -

Changes in the observability of the valuation attributes may result in a reclassification of certain financial assets or liabilities. Such reclassifications are reported as transfers in or out at fair value in the year in which the changes occurs.

Fair Value on a Nonrecurring Basis

The Bank measures certain loans at fair value on a nonrecurring basis. These loans are subject to fair value adjustments only in certain circumstances (i.e., when there is evidence of other-than-temporary impairment). The following table presents for each SFAS 157 hierarchy level the financial assets and liabilities that are measured at fair value on a non-recurring basis on the Balance Sheet as of December 31, 2008.

	As of December 31, 2008			
Fair Value Hierarchy	**Total**	**Level 1**	**Level 2**	**Level 3**
Impaired loans net of related allowance for loan loss	$ 1,055,000			$ 1,055,000
Total assets at fair value	$ 1,055,000	$ -	$ -	$ 1,055,000

The changes in Level 3 assets measured at fair value on a non-recurring basis were not material for the year ended December 31, 2008.

Estimated fair values are disclosed for financial instruments for which it is practicable to estimate fair value. These estimates are made as of a specific point in time based on relevant market data and information about the

NOTE 15 - DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

financial instruments. These estimates do not reflect any premium or discount that could result from offering the Bank's entire holdings of a particular financial instrument for sale at one time, nor do they attempt to estimate the value of anticipated future business related to the instruments. In addition, the tax ramifications related to the realization of unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of these estimates.

Because no market exists for a significant portion of the Bank's financial instruments, fair value estimates are based on judgments regarding current economic conditions, risk characteristics of various financial instruments and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the fair value presented.

The following methods and assumptions were used by the Bank to estimate the fair value of its financial instruments at December 31, 2008 and 2007:

Cash and cash equivalents and short-term borrowings: For cash and cash equivalents and short-term borrowings, the carrying amount is estimated to be fair value.

Held-to-maturity investment securities: The fair values of held-to-maturity investment securities are based on quoted market prices, where available. If quoted market prices are not available, fair values are estimated using quoted market prices for similar securities and indications of value provided by brokers.

Federal Home Loan Bank stock: For Federal Home Loan Bank stock, cost approximates fair value.

Loans: For variable-rate loans that reprice frequently with no significant change in credit risk, fair values are based on carrying values. Fair values of loans held for sale are estimated using quoted market prices for similar loans. The fair values for other loans are estimated using discounted cash flow analyses, using interest rates offered at each reporting date for loans with similar terms to borrowers of comparable creditworthiness. The carrying amount of accrued interest receivable approximates its fair value.

Cash surrender value of life insurance policies: The fair value of the cash surrender value of life insurance policies is based on the current cash surrender value provided by the insurers.

Deposits: The fair values for demand deposits are, by definition, equal to the amount payable on demand at the reporting date represented by their carrying amount. Fair values for fixed-rate certificates of deposit are estimated using discounted cash flow analyses using interest rates offered at each reporting date by the Bank for certificates with similar remaining maturities. The carrying amount of accrued interest payable approximates its fair value.

Commitments to extend credit and standby letters of credit: 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 15 - DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

The estimated fair values of the Bank's financial instruments are as follows:

	December 31, 2008		December 31, 2007	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:				
Cash and due from banks	$ 10,394,248	$ 10,394,248	$ 7,571,866	$ 7,571,866
Federal funds sold	-	-	15,275,000	15,275,000
Time deposits with other institutions	9,097,000	9,088,292	2,693,000	2,694,912
Available-for-sale investment securities	6,350,687	6,350,687	2,748,783	2,748,783
Held-to-maturity investment securities	1,822,844	1,823,519	5,008,943	4,945,238
Federal home loan bank stock	965,900	965,900	735,700	735,700
Loans, net	172,665,005	171,154,440	128,219,309	127,545,972
Cash surrender value of life insurance policies	2,535,877	2,535,877	2,434,632	2,434,632
Accrued interest receivable	762,975	762,975	692,460	692,460
Financial liabilities:				
Deposits	175,903,576	175,986,469	141,376,069	140,611,868
Short-term borrowings	14,000,000	14,037,879	6,000,000	6,000,000
Accrued interest payable	197,000	197,000	262,349	262,349

NOTE 16 – SUBSEQUENT EVENTS

Preferred Stock

On January 9, 2009 the Bank issued 5,500 shares of the Bank’s Fixed Rate Non-Cumulative Perpetual Preferred Stock, Series A (“Series A Preferred Stock”) and a related warrant for 275 shares of Fixed Rate Non-Cumulative Perpetual Preferred Stock, Series B (“Series B Preferred Stock”) to the U.S. Treasury in connection with Bank’s participation in Troubled Asset Relief Program (TARP).

NOTE 16 – SUBSEQUENT EVENTS (CONTINUED)

Troubled Asset Relief Program (TARP)

The TARP Capital Purchase Program, created by the U.S. Treasury, is a voluntary program in which selected healthy financial institutions were encouraged to participate.

On January 9, 2009 the Bank received $5.5 million as an approved participant in the U.S. Treasury Department's TARP Capital Purchase Program. The Bank issued 5,500 shares of Series A Preferred Stock and a related warrant for 275 shares of Series B Preferred Stock, which represents 5% of the Series A Preferred Stock amount or $275,000, to the U.S. Treasury.

The Series A Preferred Stock issued by the Bank will pay non-cumulative cash dividends at an initial rate per annum equal to 5% on $1,000 per share for the first 5 years, after which the rate will increase to 9% if the Bank does not redeem the preferred shares. The Series B Preferred Stock issued by the Bank will pay non-cumulative cash dividends at a rate per annum equal to 9% on $1,000 per share. Dividends are payable quarterly in arrears on February 15, May 15, August 15 and November 15 of each year.

The dividends will be paid only as declared by the Board of Directors of the Bank. However, in the event such dividends have not been paid for an aggregate of six or more quarterly dividend periods, whether or not consecutive, the holders of the Series A Preferred Stock and Series B Preferred Stock have the right to elect two directors at the Bank's next annual meeting of stockholders and at each subsequent annual meeting of stockholders until the full dividends have been paid for at least four consecutive dividend periods.

These preferred shares do not carry voting rights, except in certain limited circumstances.

For as long as Series A and Series B Preferred Stock is outstanding, no dividends may be declared or paid on common shares unless the full dividend for the latest completed dividend period of Series A and Series B Preferred Stock has been declared and paid in full.

Bank Officers

Richard P. Loupe, *President & Chief Executive Officer*

Greg J. Hickel, *Executive Vice President & Chief Credit Officer*

Rebecca I. Holowich, *Executive Vice President & Chief Financial Officer*

John Angelesco, *Senior Vice President & San Jose Office Manager*

Jenny Boister, *Senior Vice President & SBA Department Manager*

W. Brent Chaney, *Senior Vice President & Pleasanton Office Manager*

Cindy Chase, *Senior Vice President & Construction Loan Officer*

Howard Hoover, *Senior Vice President & SBA Lending Officer*

Sati Kanwar, *Senior Vice President & SBA Lending Officer*

Rick J. Peterson, *Senior Vice President & Livermore Office Manager*

Randy Ruddach, *Senior Vice President & San Ramon Office Manager*

John Herzog, *First Vice President*

Bernie Billen, *Vice President & Business Development Officer*

Lloyd Coleman, *Vice President & Real Estate Construction*

Michael Cook, *Vice President & Controller / Risk Officer*

Geri Fernandez, *Vice President & Credit Underwriter*

Jim Isaac, *Vice President & Business Development Officer*

Donna Moehring, *Vice President & Operations / Business Development*

Susan Siauw, *Vice President & Credit Administrator*

Tanya Tokar, *Vice President & Credit Services Manager*

Genelle Wrzesinski, *Vice President / Administrative / BSA / Compliance Officer*

Board of Directors

Phillip R. Boyce, *Chairman*

Jerome W. Carlson

William M. Eames

Richard P. Loupe, *President, CEO & Secretary of the Board*

Peter MacDonald

Dean L. Schenone

Anelli P. Stamm

Pleasanton Office:
465 Main Street
Pleasanton, CA 94566
Tel: (925) 484-5400
Fax: (925) 484-9073

Livermore Office:
1986 Second Street
Livermore, CA 94550
Tel: (925) 243-9600
Fax: (925) 243-8854

San Ramon Office:
2355 San Ramon Valley Blvd.
Suite 101
San Ramon, CA 94583
Tel: (925) 855-3800
Fax: (925) 820-6691

San Jose Office:
1150 South Bascom Avenue
Suite 29
San Jose, CA 95128-3509
Tel: (408) 275-7150
Fax: (408) 275-7154

Santa Cruz Office:
740 Front Street
Suite 310
Santa Cruz, CA 95060
Tel: (831) 421-0236
Fax: (831) 421-0860

Livermore Administration Office:
1986 Second Street
Livermore, CA 94550
Tel: (925) 243-8995
Fax: (925) 243-8853

Pleasanton Corporate Office:
5000 Pleasanton Avenue
Suite 210
Pleasanton, CA 94566
Tel: (925) 621-7200
Fax: (925) 484-1804

EQUAL HOUSING LENDER

www.vcb-ca.com

MEMBER FDIC

004CT14670