2006 Annual Report









Where Locals Bank.

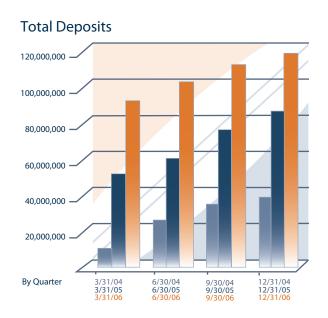


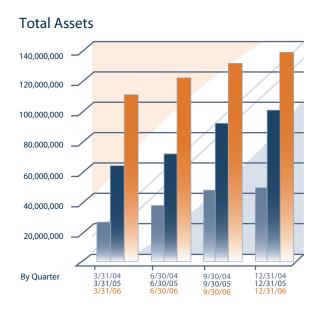
SANTA CRUZ COUNTY BANK: 2004, 2005, 2006

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. All of our deposit products are augmented by state-of-the-art services, both personal and electronic, including online banking, bill payment, cash management, and merchant services.

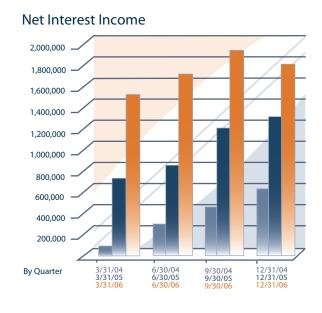
Santa Cruz County Bank operates three banking offices located in Santa Cruz, Scotts Valley, and Watsonville and will to open a fourth banking office in Capitola in 2007. To provide further convenience for our clients, the Bank operates two self-serve ATM and Night Depositories in Santa Cruz and Aptos and a Business Lending Center on 41st Avenue, Capitola.

Santa Cruz County Bank is the only locally owned commercial bank in Santa Cruz County.









LETTER TO SHAREHOLDERS



To Our Shareholders, Employees, Clients, and Friends,

It is with pleasure that we present our annual report for the year-ended December 31, 2006. This report reflects nearly three years of operations since the opening of our doors in February 2004. In this time, your Bank has achieved many significant milestones including the opening of three full-service banking offices, establishing two self-serve ATM & Night Depositories, and achieving profitability ahead of our original business plan projections.

Your Bank has grown to over \$132 million in assets as of year-end 2006. One of our strategic goals for 2006 was to establish steadily increasing profitability while still incurring the additional expenses involved with growing the Bank in order to establish and achieve greater accessibility and state of the art products and services. In 2006, we achieved positive net income and established growth of profitability quarter over quarter. Also, for year-end 2006 in comparison to year-end 2005, we reported double-digit increases in our total deposits, gross loans, and total assets.

We are proud to announce that our performance for the year-ended 2006 resulted in the designation of Santa Cruz County Bank as a **Premier Performer** by the Findley Reports, Inc., a highly regarded financial industry consulting firm. For a bank to achieve this rating it must meet the Premier Performance key ratios and growth rates established by Findley Reports, Inc.

Looking Forward, 2007 and Beyond

In the first quarter of 2007, Santa Cruz County Bank celebrated its third anniversary. As we look ahead to our next three years, our focus will be on continuing to expand our accessibility within the County, keeping ahead of, or on pace with our competitors and remaining true to our mission to be the local bank of choice for individuals and businesses in our community.

In the second quarter of 2007, we plan to launch two additional facilities in Mid-County, both slated to open in the second quarter of 2007.

The first new facility will be a "stand alone" Business Lending Office located at 1500 41st Avenue, Capitola and will provide a more centralized location for the convenience of our clients. In addition, with 41st Avenue being one of the most highly traveled roads in our

LETTER TO SHAREHOLDERS

County, it will create increased visibility and awareness of both our Bank in general and our lending capabilities. Our new Business Lending Office will be home to the Bank's Small Business Administration (SBA) Department and many of the Bank's primary Commercial, Construction and Business Lending officers. While the Business Lending Office's primary focus will be on loan production, the office will also include an ATM and Night Depository to offer greater convenience to our clients.

Our second new facility, our Capitola Office, will be our fourth full-service banking office in the County. This new banking office will be located at 819 Bay Avenue in Capitola, in a newly remodeled "one-stop" shopping center which is home to Nob Hill Foods, Longs Drugs, Peet's Coffee, a dry cleaner business, and other retail shops. Our new Capitola Office will be led by Karen Marcum, a well-known local banker with a 28 year banking background, who joined the Bank in 2005.

Both of the planned new facilities in mid-County are consistent with our plan to fill in the geographic gaps between our anchor locations in Santa Cruz, Scotts Valley, and Watsonville. We look forward to providing greater access and opportunities to facilitate the production of new loans while growing deposits.

Other strategic initiatives in the near future include the recruitment of top quality individuals to help us grow the Bank in a safe and sound way, particularly in augmenting our SBA lending activity. We will also continue to recruit in other areas of client services so that we maintain excellence in service as we grow.

Our focus remains on our commitment to serving our clients with a relationship-driven, personalized touch and in doing so, continuing to set ourselves apart from our competition.

We thank you for your investment, for choosing us as your personal or business bank, and for your referrals!

George Gallucci

Chairman of the Board

David V. Heald President and CEO

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, 2006, and 2005 and the related statements of operations, changes in stockholders' equity and other comprehensive income, and cash flows for the period from February 3, 2004 (inception) through December 31, 2004, and for the years ended December 31, 2005 and 2006. 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, 2006 and 2005 and the results of its operations and its cash flows for the period from February 3, 2004 (inception) through December 31, 2004, and for the years ended December 31, 2005 and 2006 in conformity with accounting principles generally accepted in the United States of America.

Palo Alto, California

Vowninck Trime Day + Co. LLP

March 29, 2007

STATEMENTS OF CONDITION

		Decen	ibei 3	1,
	•	2006		2005
Assets				
Cash and due from banks (notes 1, 12 and 14)	\$	4,729,046	\$	3,435,744
Federal funds sold		19,178,353		8,371,450
Total cash and cash equivalents		23,907,399		11,807,194
Investment securities (notes 1, 2 and 14):				
Securities held-to-maturity		1,264,059		1,516,583
Securities available-for-sale, at fair value		18,624,988		14,945,100
Total investment securities		19,889,047		16,461,683
Federal Home Loan Bank stock, at cost		346,900		159,300
Loans (notes 1, 3, 12 and 14):				
Gross loans		82,538,994		64,671,489
less deferred loan fees, net of costs		245,423		266,888
less reserve for loan losses		1,276,000		840,000
Net loans		81,017,571		63,564,601
Premises and equipment, net (notes 1, 4 and 12)		1,360,146		1,594,947
Accrued interest receivable		712,627		396,767
Bank owned life insurance		3,331,971		3,208,894
Other assets		1,895,398		334,957
Office addition		1,000,000		004,007
Total Assets	\$	132,461,059	\$	97,528,343
Liabilities:				
Deposits (note 14):				
Noninterest-bearing demand deposits	\$	33,693,998	\$	22,361,481
Interest-bearing demand deposits		6,382,888		6,285,261
Savings and money market deposits		44,979,206		39,678,678
Time deposits (note 6)		27,925,451		13,359,431
Total deposits		112,981,543		81,684,851
Other liabilities				
Accrued interest payable		401,544		157,458
Other liabilities		1,474,465		338,140
Total Liabilities		114,857,552		82,180,449
Shareholders' Equity:				
Common stock, no par value, 30,000,000 shares authorized:				
issued and outstanding; 1,648,374 shares at December 31,				
2006 and 1,614,642 shares at December 31, 2005		18,429,623		18,091,652
Additional paid-in-capital		198,342		-
Accumulated deficit		(427,477)		(2,595,149
Accumulated other comprehensive loss (note 1)		(596,981)		(148,609
Total Shareholders' Equity		17,603,507		15,347,894
Total liabilities and shareholders' equity	\$	132,461,059	\$	97,528,343
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December 31,

See accompanying notes to the Financial Statements

STATEMENTS OF OPERATIONS

	ear Ended mber 31, 2006	Year Ended December 31, 2005		Fe (Period from bruary 3, 2004 (inception) to ember 31, 2004
Interest income:					
Interest and fees on loans	\$ 7,283,351	\$	3,869,243	\$	1,043,173
Investment securities	881,110		328,370		174,407
Federal funds sold and other interest income	529,078		327,625		76,801
Total interest income	8,693,539		4,525,238		1,294,381
Interest expense:					
Deposits (note 6) and other borrowed funds (note 7)	2,038,149		744,576		137,190
Net interest income before provision for loan losses	6,655,390		3,780,662		1,157,191
Provision for loan losses (notes 1 and 3)	436,000		433,000		407,000
Net interest income after provision for loan losses	 6,219,390		3,347,662		750,191
Non-interest income:					
Service charges on deposit accounts	200,388		116,377		30,206
Other non-interest income (note 15)	570,758		291,243		144,765
Total non-interest income	771,146		407,620		174,971
Non-interest expense:					
Salaries and employee benefits	3,419,206		2,616,119		1,636,533
Occupancy	455,606		384,864		212,682
Furniture and equipment	344,678		276,083		150,884
Marketing and business development	190,059		152,095		92,793
Item and data processing	181,022		146,617		76,980
Professional services	248,545		103,428		76,435
Other operating expenses (note 15)	670,765		490,350		264,550
Total non-interest expense	5,509,881		4,169,556		2,510,857
Income (loss) before income taxes	1,480,655		(414,274)		(1,585,695)
Income tax expense (benefit) (notes 1 and 5)	(687,017)		800		800
Net income (loss)	\$ 2,167,672	\$	(415,074)	\$	(1,586,495)
Earnings (loss) per share (note 1):					
basic	\$ 1.32	\$	(0.29)	\$	(1.20)
diluted	\$ 1.23	\$	(0.29)	\$	(1.20)

See accompanying notes to the Financial Statements

STATEMENT OF SHAREHOLDERS' EQUITY Period from February 3, 2004 (inception) to December 31, 2006

	Common Shares	Amount	Additional Paid In Accum Capital Def		Other Comprehensive Income	Total Shareholders' Equity
Balance at February 3, 2004 (inception)	-	\$ -	\$ -	\$ -	\$ -	\$ -
Pre-opening costs	-	-	-	(593,580)	-	(593,580)
Proceeds from stock offering, net of						
offering expenses of \$76,600	1,320,000	13,123,400	-	-	-	13,123,400
Net loss	-	-	-	(1,586,495)	-	(1,586,495)
Change in unrealized losses on securities						
available-for-sale, net of tax effect of \$0	-	-	-	-	(22,249)	(22,249)
Balances 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
Common stock issued for exercise of stock options	525	5,910	-	-	-	5,910
Net loss	-	-	-	(415,074)	-	(415,074)
Change in unrealized losses on securities						
available-for-sale, net of tax effect of \$0	-	-	-	-	(126,360)	(126,360)
Balances at December 31, 2005	1,614,642	18,091,652	-	(2,595,149)	(148,609)	15,347,894
Common stock issued for exercise of stock options	33,732	337,971	-	-	-	337,971
Net income	-	-	-	2,167,672	-	2,167,672
Stock-based compensation on stock options	-	-	115,159	-	-	115,159
Tax benefit from exercise of non-qualified stock options	-	-	83,183	-	-	83,183
Additional minimum pension liability adjustment	-	-	-	-	(518,345)	(518,345)
Change in unrealized losses on securities						
available-for-sale	-	-	-	-	69,973	69,973
Balances at December 31, 2006	1,648,374	\$ 18,429,623	\$ 198,342	\$ (427,477)	\$ (596,981)	\$ 17,603,507

See accompanying notes to the Financial Statements

STATEMENTS OF CASH FLOWS

Operating Activities: Net income (loss) \$ Adjustments to reconcile net loss to net cash provided by operating activities: Income tax benefit Depreciation and amortization of furniture, fixtures and equipment Increase in cash value of bank owned life insurance Provision for loan losses Net amortization/accretion of investment discounts and premiums Net other amortization and accretion (Gain) on sale of available-for-sale securities (Gain) on sale of SBA loans Stock-based compensation Net (increase)/decrease in: Interest receivable Other assets Net increase/(decrease) in: Accrued interest payable Other liabilities Increase (decrease) in deferred loan fees Total adjustments Net cash provided/(used) by operating activities Investing Activities: Held-to-maturity securities: Principal repayments Purchases Available-for-sale securities: Sales	2,167,672	\$ (415,074)	
Adjustments to reconcile net loss to net cash provided by operating activities: Income tax benefit Depreciation and amortization of furniture, fixtures and equipment Increase in cash value of bank owned life insurance Provision for loan losses Net amortization/accretion of investment discounts and premiums Net other amortization and accretion (Gain) on sale of available-for-sale securities (Gain) on sale of SBA loans Stock-based compensation Net (increase)/decrease in: Interest receivable Other assets Net increase/(decrease) in: Accrued interest payable Other liabilities Increase (decrease) in deferred loan fees Total adjustments Net cash provided/(used) by operating activities Investing Activities: Held-to-maturity securities: Principal repayments Purchases Available-for-sale securities:		\$ (415,074)	
operating activities: Income tax benefit Depreciation and amortization of furniture, fixtures and equipment Increase in cash value of bank owned life insurance Provision for loan losses Net amortization/accretion of investment discounts and premiums Net other amortization and accretion (Gain) on sale of available-for-sale securities (Gain) on sale of SBA loans Stock-based compensation Net (increase)/decrease in: Interest receivable Other assets Net increase/(decrease) in: Accrued interest payable Other liabilities Increase (decrease) in deferred loan fees Total adjustments Net cash provided/(used) by operating activities Investing Activities: Held-to-maturity securities: Principal repayments Purchases Available-for-sale securities:	(687,817)		\$ (1,586,495)
Income tax benefit Depreciation and amortization of furniture, fixtures and equipment Increase in cash value of bank owned life insurance Provision for loan losses Net amortization/accretion of investment discounts and premiums Net other amortization and accretion (Gain) on sale of available-for-sale securities (Gain) on sale of SBA loans Stock-based compensation Net (increase)/decrease in: Interest receivable Other assets Net increase/(decrease) in: Accrued interest payable Other liabilities Increase (decrease) in deferred loan fees Total adjustments Net cash provided/(used) by operating activities Investing Activities: Held-to-maturity securities: Principal repayments Purchases Available-for-sale securities:	(687,817)		
Depreciation and amortization of furniture, fixtures and equipment Increase in cash value of bank owned life insurance Provision for loan losses Net amortization/accretion of investment discounts and premiums Net other amortization and accretion (Gain) on sale of available-for-sale securities (Gain) on sale of SBA loans Stock-based compensation Net (increase)/decrease in:	(687,817)		
Increase in cash value of bank owned life insurance Provision for loan losses Net amortization/accretion of investment discounts and premiums Net other amortization and accretion (Gain) on sale of available-for-sale securities (Gain) on sale of SBA loans Stock-based compensation Net (increase)/decrease in:		-	-
Provision for loan losses Net amortization/accretion of investment discounts and premiums Net other amortization and accretion (Gain) on sale of available-for-sale securities (Gain) on sale of SBA loans Stock-based compensation Net (increase)/decrease in:	376,890	318,089	161,454
Net amortization/accretion of investment discounts and premiums Net other amortization and accretion (Gain) on sale of available-for-sale securities (Gain) on sale of SBA loans Stock-based compensation Net (increase)/decrease in:	(123,077)	(118,516)	(90,378)
Net other amortization and accretion (Gain) on sale of available-for-sale securities (Gain) on sale of SBA loans Stock-based compensation Net (increase)/decrease in: Interest receivable Other assets Net increase/(decrease) in: Accrued interest payable Other liabilities Increase (decrease) in deferred loan fees Total adjustments Net cash provided/(used) by operating activities Investing Activities: Held-to-maturity securities: Principal repayments Purchases Available-for-sale securities:	436,000	433,000	407,000
Net other amortization and accretion (Gain) on sale of available-for-sale securities (Gain) on sale of SBA loans Stock-based compensation Net (increase)/decrease in: Interest receivable Other assets Net increase/(decrease) in: Accrued interest payable Other liabilities Increase (decrease) in deferred loan fees Total adjustments Net cash provided/(used) by operating activities Investing Activities: Held-to-maturity securities: Principal repayments Purchases Available-for-sale securities:	(48,269)	(497)	15,739
(Gain) on sale of SBA loans Stock-based compensation Net (increase)/decrease in: Interest receivable Other assets Net increase/(decrease) in: Accrued interest payable Other liabilities Increase (decrease) in deferred loan fees Total adjustments Net cash provided/(used) by operating activities Investing Activities: Held-to-maturity securities: Principal repayments Purchases Available-for-sale securities:	28,409	79,243	20,416
(Gain) on sale of SBA loans Stock-based compensation Net (increase)/decrease in: Interest receivable Other assets Net increase/(decrease) in: Accrued interest payable Other liabilities Increase (decrease) in deferred loan fees Total adjustments Net cash provided/(used) by operating activities Investing Activities: Held-to-maturity securities: Principal repayments Purchases Available-for-sale securities:	-	-	(19,503)
Stock-based compensation Net (increase)/decrease in: Interest receivable Other assets Net increase/(decrease) in: Accrued interest payable Other liabilities Increase (decrease) in deferred loan fees Total adjustments Net cash provided/(used) by operating activities Investing Activities: Held-to-maturity securities: Principal repayments Purchases Available-for-sale securities:	(236,941)	(81,712)	(19,677)
Net (increase)/decrease in:	115,159	(01,712)	(10,011)
Interest receivable Other assets Net increase/(decrease) in: Accrued interest payable Other liabilities Increase (decrease) in deferred loan fees Total adjustments Net cash provided/(used) by operating activities Investing Activities: Held-to-maturity securities: Principal repayments Purchases Available-for-sale securities:	110,100		
Other assets Net increase/(decrease) in: Accrued interest payable Other liabilities Increase (decrease) in deferred loan fees Total adjustments Net cash provided/(used) by operating activities Investing Activities: Held-to-maturity securities: Principal repayments Purchases Available-for-sale securities:	(315,860)	(269,919)	(126,848)
Net increase/(decrease) in: Accrued interest payable Other liabilities Increase (decrease) in deferred loan fees Total adjustments Net cash provided/(used) by operating activities Investing Activities: Held-to-maturity securities: Principal repayments Purchases Available-for-sale securities:	, , ,	(41,341)	(293,616)
Accrued interest payable Other liabilities Increase (decrease) in deferred loan fees Total adjustments Net cash provided/(used) by operating activities Investing Activities: Held-to-maturity securities: Principal repayments Purchases Available-for-sale securities:	(429,083)	(41,341)	(293,616)
Other liabilities Increase (decrease) in deferred loan fees Total adjustments Net cash provided/(used) by operating activities Investing Activities: Held-to-maturity securities: Principal repayments Purchases Available-for-sale securities:	044.000	440.000	20,000
Increase (decrease) in deferred loan fees Total adjustments Net cash provided/(used) by operating activities Investing Activities: Held-to-maturity securities: Principal repayments Purchases Available-for-sale securities:	244,086	118,068	39,390
Total adjustments Net cash provided/(used) by operating activities Investing Activities: Held-to-maturity securities: Principal repayments Purchases Available-for-sale securities:	218,953	200,820	137,320
Net cash provided/(used) by operating activities Investing Activities: Held-to-maturity securities: Principal repayments Purchases Available-for-sale securities:	(21,465)	82,341	184,547
Investing Activities: Held-to-maturity securities: Principal repayments Purchases Available-for-sale securities:	(443,015)	719,576	415,844
Held-to-maturity securities: Principal repayments Purchases Available-for-sale securities:	1,724,657	304,502	(1,170,651)
Principal repayments Purchases Available-for-sale securities:			
Purchases Available-for-sale securities:			
Available-for-sale securities:	247,621	289,206	207,535
	-	-	(2,027,969)
Solos			
Sales	-	-	948,394
Maturities	4,000,000	1,000,000	-
Principal repayments	617,123	553,179	328,949
Purchases	(8,173,866)	(12,912,392)	(5,012,436)
Increase in Federal Home Loan Bank stock	(187,600)	(32,100)	(127,200)
Net proceeds from sales of loans	2,788,764	988,593	264,111
Purchase of bank owned life insurance	-	-	(3,000,000)
Net increase in loans	(20,409,068)	(33,114,945)	(32,788,015)
Purchase of premises and equipment	(142,089)	(766,714)	(1,307,776)
Net cash used by investing activities	(21,259,115)	(43,995,173)	(42,514,407)
Financing Activities:			
Net proceeds from sale of common stock	337,971	4,968,252	13,123,400
Pre-opening costs	-	-	(593,580)
Increase in:			
Demand deposits	11,430,144	16,072,275	12,574,467
Savings and money market deposits	5,300,528	24,716,546	14,962,132
Time deposits	14,566,020	7,100,575	6,258,856
Net cash provided by financing activities	31,634,663	52,857,648	46,325,275
Net increase in cash and cash equivalents	12,100,205	9,166,977	2,640,217
Cash and cash equivalents at beginning of period	11,807,194	2,640,217	
Cash and cash equivalents at beginning of period \$	23,907,399	\$ 11,807,194	\$ 2,640,217
Total interest paid \$	1,794,064	\$ 626,508	\$ 97,800
Total income taxes paid	1 / 4/1 / 16/1	Ψ 020.000	800

December 31, 2006 and 2005

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 original main office in Santa Cruz, California, a branch office in Scotts Valley, California, and a branch office in Watsonville, California. 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 approval from the California Department of Financial Institutions and the issuance of deposit insurance by the Federal Deposit Insurance Corporation. The Bank is subject to competition from other financial institutions. Additionally, the Bank is subject to regulations by the above referenced regulatory agencies and undergoes periodic examinations by those agencies.

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 202 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, 2006, the Bank had loans outstanding of approximately \$60,064,000 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 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 and federal funds sold. Federal funds sold for a one day period 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, 2006, 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 effective interest method. 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.

December 31, 2006 and 2005

A decline in the market value of any available-for-sale security below cost that is 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 fees, and reduced by an allowance for loan losses. Accrual of interest is 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 charged against 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 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 or adjusting an existing allocation of the allowance for loan losses.

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)

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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 collectibility of the principal is unlikely. The allowance is a reserve to provide for possible losses on existing loans that may become uncollectible, based on evaluations of the collectibility of loans and prior loan loss experience. The evaluations include consideration of changes in the nature and volume of the loan portfolio, overall portfolio quality, 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.

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.

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 carryforwards depends on having sufficient taxable income of an appropriate character within the carryforward periods.

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

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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. The Bank has recorded an incremental \$115,159 of stock-based compensation expense during 2006, \$93,759 net of related tax benefits, as a result of the adoption of SFAS No. 123R. The impact of implementing SFAS No. 123R reduced basic earnings per share by \$0.06 and diluted earnings per share by \$0.05 for the year ended December 31, 2006.

No stock-based compensation costs were capitalized as part of the cost of an asset as of December 31, 2006. As of December 31, 2006, \$198,000 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 and 2004, the Bank's net loss and loss per share would have been increased to the pro forma amounts indicated below:

	2005	2004		
Net Loss:				
As reported	\$ (415,074)	\$ (1,586,495)		
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)	(120,790)		
Pro forma	\$ (542,970)	\$ (1,707,285)		
Earnings (loss) per share:				
As reported	\$ (0.29)	\$ (1.20)		
Pro forma	\$ (0.38)	\$ (1.29)		

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. There is no adjustment to the number of outstanding shares for potential dilutive instruments, such as stock options. 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

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number of shares outstanding. The following table summarizes the weighted average shares outstanding used to compute earnings per share:

	December 31,								
		2006		2005		2004			
Net Income (loss), as reported	\$	2,167,672	\$	(415,074)	\$	(1,586,495)			
Earnings (loss) per share, basic	\$	1.32	\$	(0.29)	\$	(1.20)			
Earnings (loss) per share, diluted	\$	1.23	\$	(0.29)	\$	(1.20)			
Weighted average shares outstanding, basic		1,640,528		1,428,330		1,320,000			
Weighted average shares outstanding, diluted		1,761,684		1,428,330		1,320,000			

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 totaling (\$448,372), net of tax, at December 31, 2006, (\$126,360), at December 31, 2005 and (\$22,249), at December 31, 2004.

	 2006	2005	2004
Net income (loss)	\$ 2,167,672 \$	(415,074) \$	(1,586,495)
Other comprehensive income (loss):			
FASB 158 adjustment Unrealized gain (loss)	(518,345)	-	-
on securities available for sale	 69,973	(126,360)	(22,249)
Total comprehensive income (loss)	\$ 1,719,300 \$	(541,434) \$	(1,608,744)

Recent Accounting Announcements. In May 2005, the Financial Accounting Standards Board issued SFAS No. 154, "Accounting Changes and Error Corrections". SFAS No. 154 provides guidance on the accounting for and reporting of accounting changes and error corrections. It establishes, unless impracticable, retrospective application as the required method for reporting a change in accounting principle in the absence of explicit transition requirements specific to the newly adopted accounting principle. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The adoption of SFAS No. 154, effective January 1, 2006, did not have any impact on our financial condition or operating results.

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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, among 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 Bank for January 1, 2007, SFAS No. 155 is not expected to have any impact on our financial position, results of operations or cash flows.

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 Bank beginning January 1, 2007; however, the standard is not expected to have a material effect on the Bank's financial position, results of operations or cash flows.

In June 2006, the Financial Accounting Standards Board issued FIN No. 48, "Accounting for Uncertainty in Income Taxes". This interpretation clarifies the accounting for uncertainty in income taxes in a company's financial statements, in accordance with SFAS No. 109, "Accounting for Income Taxes", by prescribing the minimum recognition threshold a tax position must meet before being recognized in the financial statements. FIN No. 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure, and transition. We do not expect FIN No. 48, which is effective for fiscal years beginning after December 15, 2006, to have a material impact on our financial condition or operating results.

In September 2006, the Financial Accounting Standards Board 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 a company measures 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. We will adopt SFAS No. 157 on January 1, 2008, and we do not expect the adoption of SFAS No. 157 to have a material impact on our financial condition or operating results.

In September 2006, the Financial Accounting Standards Board issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans", which requires employers to fully recognize the obligations associated with single-employer defined benefit pension, retiree healthcare and other postretirement plans in their financial statements. The

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standard will make it easier for investors, employees, retirees and others to understand and assess an employer's financial position and its ability to fulfill the obligations under its benefit plans. Specifically, SFAS No. 158 requires an employer to (a) recognize in its balance sheet an asset for a plan's overfunded status or a liability for a plan's underfunded status; (b) measure a plan's assets and its obligations that determine its funded status as of the end of the employer's fiscal year (with limited exceptions); and (c) recognize changes in the funded status of a defined benefit postretirement plan in the year in which the changes occur. Those changes are reported as a component of other comprehensive income. The requirement to recognize the funded status of a benefit plan and the disclosure requirements are effective as of December 31, 2006. The adoption of SFAS No. 158 did not have any impact on our operating results but did result in a one-time charge to other comprehensive income (equity) in the amount of \$518,345, net of related deferred tax benefits of \$362,511.

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.

Note 2. Investment Securities

The following table summarizes Santa Cruz County Bank's securities held-to-maturity and available-for-sale at December 31, 2006, and December 31, 2005:

2006	Amortized Cost	Unrealized Gains	Unrealized Losses		Fair Value	
Securities available-for-sale:						
Government agency securities	\$ 16,188,465	\$ 14,890	\$ (40,119)	\$	16,163,236	
Mortgage-backed securities	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:						
Mortgage-backed securities	\$ 1,264,059	\$ -	\$ (46,638)	\$	1,217,421	
Total securities held-to-maturity	\$ 1,264,059	\$ -	\$ (46,638)	\$	1,217,421	
2005						
Securities available-for-sale:						
Government agency securities	\$ 11,957,857	\$ -	\$ (61,087)	\$	11,896,770	
Mortgage-backed securities	3,135,852	-	(87,522)		3,048,330	
Total securities available-for-sale	\$ 15,093,709	\$ -	\$ (148,609)	\$	14,945,100	
Securities held-to-maturity:						
Mortgage-backed securities	\$ 1,516,583	\$ -	\$ (62,349)	\$	1,454,234	
Total securities held-to-maturity	\$ 1,516,583	\$ -	\$ (62,349)	\$	1,454,234	

December 31, 2006 and 2005

The amortized cost and estimated fair value of investment securities at December 31, 2006 and December 31, 2005, by contractual maturity, are shown below, except for mortgage-backed securities and other securities which are presented in total. Expected maturities on mortgage-backed securities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

		Securities ava	ailab	ole-for-sale	Securities held-to-maturity						
2006	Amortized Cost			Fair Value		Amortized Cost		Fair Value			
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			
2005											
Due in one year or less	\$	3,995,670	\$	3,978,320	\$	-	\$	-			
Due after one year through five years		7,962,187		7,918,450		-		-			
Mortgage-backed securities		3,135,852		3,048,330		1,516,583		1,454,234			
Total	\$	15,093,709	\$	14,945,100	\$	1,516,583	\$	1,454,234			

Investment securities in a temporary unrealized loss position as of December 31, 2006 are shown in the following table, based on the time they have been continuously in an unrealized loss position:

_	Less than	12 N	lonths	12 Months or Longer		_	Tot	tal			
		U	nrealized			Uı	nrealized			Ur	nrealized
!	air Value		Losses		Fair Value Loss		Losses	Fair Value		Losses	
\$	2,191,286	\$	9,379	\$	7,957,060	\$	30,740	\$	10,148,346	\$	40,119
	-		-		2,461,752		53,407		2,461,752		53,407
\$	2,191,286	\$	9,379	\$	10,418,812	\$	84,147	\$	12,610,098	\$	93,526
	\$	Fair Value \$ 2,191,286	Fair Value \$ 2,191,286 \$	\$ 2,191,286 \$ 9,379	### Unrealized Losses ###	Unrealized Fair Value Losses Fair Value \$ 2,191,286 \$ 9,379 \$ 7,957,060 - - 2,461,752	Unrealized Unrealized Unrealized Series Seri	Unrealized Unrealized Unrealized Fair Value Losses Fair Value Losses \$ 2,191,286 \$ 9,379 \$ 7,957,060 \$ 30,740 - - 2,461,752 53,407	Unrealized Unrealized Fair Value Losses Fair Value Losses \$ 2,191,286 \$ 9,379 - - 2,461,752 53,407	Fair Value Unrealized Losses Unrealized Fair Value Unrealized Losses Fair Value \$ 2,191,286 \$ 9,379 \$ 7,957,060 \$ 30,740 \$ 10,148,346 - - 2,461,752 53,407 2,461,752	Unrealized Unrealized Unrealized Unrealized Unrealized Unrealized Unrealized Eair Value Unrealized Fair Value II \$ 2,191,286 \$ 9,379 \$ 7,957,060 \$ 30,740 \$ 10,148,346 \$ - - - 2,461,752 53,407 2,461,752

No investment securities were sold in 2005 or 2006. Investment securities required to be pledged to secure public deposits or for other purposes, required or permitted by law, at December 31, 2006 and December 31, 2005, were \$3,407,523 and \$2,429,452, respectively.

December 31, 2006 and 2005

Note 3. Loans

Loan maturity and rate sensitivity data of the loan portfolio, in thousands, at December 31, 2006 and 2005 are as follows:

		Within	One to			After Five		
		One Year		Five Years		Years		Total
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

	December 31, 2005											
		ne Year		Five Years		Years	Total					
Real estate and construction	\$	22,860	\$	5,315	\$	11,220	\$	39,395				
Consumer, other		1,437		13		1,936		3,386				
Commercial and revolving lines		11,981		5,743		4,166		21,890				
	\$	36,278	\$	11,071	\$	17,322	\$	64,671				
Loans at fixed interest rates	\$	1,281	\$	3,337	\$	7,532	\$	12,150				
Loans at variable interest rates		34,997		7,734		9,790		52,521				
	\$	36,278	\$	11,071	\$	17,322	\$	64,671				

Changes in the allowance for loan losses are as follows:

Balance December 31, 2004		\$ 407,000
Provision for loan losses		433,000
Loan charge-offs		-
Recoveries of loan charge-offs		
Balance December 31, 2005		\$ 840,000
Provision for loan losses		436,000
Loan charge-offs		-
Recoveries of loan charge-offs		-
Balance December 31, 2006		\$ 1,276,000
		_
	2006	2005
Net loan (recoveries) charge-offs as a		_
percentage of average total loans	N/A	N/A

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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 as of December 31, 2006, including the related allowance for loan losses and cash-basis income recognized. Also shown are loans on non-accrual and those that are past due and still accruing interest:

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

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, 2006 and December 31, 2005:

	December 31,			
		2006	2005	
Premises and leasehold improvements	\$	941,470 \$	890,737	
Furniture, fixtures and equipment		1,156,880	1,011,435	
Software and capitalized data & item processing		100,997	98,309	
Construction-in-progress		17,233	74,009	
Total premises and equipment		2,216,580	2,074,490	
Less accumulated depreciation and amortization		(856,434)	(479,543)	
Premises and equipment, net	\$	1,360,146 \$	1,594,947	

Depreciation expense aggregated \$376,890 for the year ended December 31, 2006 and \$318,089 for the year ended December 31, 2005.

Note 5. 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 at December 31, 2006, 2005, and 2004 are as follows:

	2006	2005	2004
Deferred pre-opening costs plus NOL's	\$ 187,000	\$ 821,000	\$ 761,000
Fixed assets	35,000		
Allowance for loan losses	371,000	351,000	166,000
Accrual to cash adjustments	149,000		
Other	29,000		
	771,000	1,172,000	927,000
Valuation allowance	-	(1,172,000)	(927,000)
Net deferred tax asset	\$ 771,000	\$ -	\$ -

December 31, 2006 and 2005

In addition to the above deferred tax asset, the Bank has additional deferred tax assets arising from adjustments to other comprehensive income aggregating \$363,000 as of December 31, 2006.

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

	2006	2005		2004	
Current:					
Federal	\$ -	\$	-	\$	-
State	 800		800		800
Total current	 800		800		800
Deferred:					
Federal	\$ (475,849)	\$	-	\$	-
State	 (211,968)		-		-
Total deferred	(687,817)		-		-
Total provision (credit)	\$ (687,017)	\$	800	\$	800

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

Federal statutory rate	34.00%
State income tax, net of federal effect	7.15%
Other permanent differences	(3.26%)
Net operating losses - current	(37.89%)
Reduction in valuation allowance	(31.69%)
Net	(31.69%)

Note 6. Time Deposits

The aggregate amount of time deposit accounts equal to or greater than \$100,000 was approximately \$18,571,000 and \$8,572,000 at December 31, 2006 and December 31, 2005, respectively. At December 31, 2006 the scheduled maturities for time deposits were as follows:

(Rounded to the nearest thousand)					
Due in 2007	\$	26,893			
Due in 2008		535			
Due in 2009		171			
Due in 2010		111			
Due in 2011		215			
Thereafter		-			
	\$	27,925			

Interest expense on time deposits of \$100,000 or more was \$567,644 and \$159,406 in 2006 and 2005, respectively.

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Note 7. Borrowed Funds

The Bank has obtained federal funds borrowing guidance lines with its correspondent banks in an aggregate amount of \$9 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. There was \$7,000 of borrowing expense in 2006 and no borrowing expense in 2005. The Bank had no borrowed funds at December 31, 2006 and at December 31, 2005.

Note 8. 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 required disclosures relating to the Bank's stock option plan for the periods presented:

		Weighted Average
	Options Outstanding	Exercise Price
Balance at December 31, 2005	311,665	\$10.20
Granted 2006	20,700	\$25.70
Exercised 2006	(33,732)	\$10.02
Cancelled 2006	(30,686)	\$10.28
Balance at December 31, 2006	267,947	\$11.42

Opti	ons Outstanding		Options Exercisable		
Number	Weighted Average Remaining Contractual Life	e Aggregate Intrinsic Value	Number	Weighted Average Exercise Price	Aggregate Intrinsic Value
December 31, 2006: 267,947	7.32 years	\$3,345,417	184,193	\$10.36	\$2,472,415
December 31, 2005: 311,665	8.13 years	\$5,858,255	154,162	\$10.08	\$2,918,116
December 31, 2004: 309,690	9.11 years	\$2,442,440	81,719	\$10.03	\$651,604

December 31, 2006 and 2005

The number and weighted average grant date fair value of options granted is as follows for the years ended December 31, 2006, 2005, and 2004:

	Number	Weighted Average Grant Date Fair Value
2006	20,700	\$5.07
2005	4,700	\$3.50
2004	309,690	\$1.58

The aggregate intrinsic value of options exercised is as follows for the years ended December 31, 2006, 2005, and 2004:

2006	\$ 587,693
2005	\$ 4,590
2004	\$ 0

The weighted average assumptions used for 2006, 2005, and 2004 in determining the fair value of options granted is as follows:

	2006	2005	2004
Expected life (yrs.)	5	5	5
Volatility	0.00%	0.00%	0.00%
Risk free rate of return	4.50%	4.41%	3.50%
Dividend yield	0.00%	0.00%	0.00%

Note 9. 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.

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The following table reflects the accumulated benefit obligation and funded status of the SERP for the years ended December 31, 2006 and 2005.

(dollars in thousands)	Year ended	December 31
	2006	2005
Change in benefit obligation		
Benefit obligation at the beginning of the year Service cost	\$ 1,076,856 -	\$ 1,012,812 -
Interest cost Amendments	55,872 -	64,044 -
Acturial (gains)/losses Acquisitions/ (disvestitures)	(59,731)	-
Expected benefits paid Projected benefit obilgation at the end of the year	-	-
rejected benefit obligation at the end of the year	1,072,997	1,076,856
Funded status	(1,072,997)	(1,076,856)
Unrecognized net acturial (gain) loss Unrecognized prior service cost	(48,739) 842,163	921,231
Unrecognized net transition obligation (assets) (Accrued)/ prepaid benefit cost	(279,573)	(155,625)
Unfunded projected/accumulated benefit obligation Additional liability	(1,072,997) (793,424)	(1,076,856) (921,231)
Intangible asset Impact on retained earnings	\$ (1,072,997)	921,231 \$ (1,076,856)
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, 2006 and 2005 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, 2007 are as follows:

(dollars in thousands)	Year ende	Year ended December 31						
	2007			2006	•	2005		
Components of net periodic benefit cost								
Service cost	\$	-	\$	-	\$	-		
Interest Cost		72,427		55,872		64,044		
Expected return on plan assets		-		-		-		
Amortization of transition obligation (asset)		-		-		-		
Amortization of prior service cost		79,068		79,068		70,830		
Amortization of acturial (gains)/ losses		-		(10,992)		-		
Net periodic benefit cost	\$	151,495	\$	123,948	\$	134,874		

December 31, 2006 and 2005

Note 10. 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. The Bank does not match employee contributions.

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 collectibility. At December 31, 2006, December 31, 2005, and December 31, 2004, 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 \$946,500, \$686,500, and \$87,000 at December 31, 2006, December 31, 2005, and December 31, 2004, respectively. Loan related activity to directors, officers and principal shareholders and their associates for the years ended December 31, 2006, December 31, 2005, and December 31, 2004 is as follows:

February 3, 2004 (inception)	\$ -
New loans or disbursements	80,899
Principal repayments	79,946
Balance at December 31, 2004	\$ 953
New loans or disbursements 2005	117,799
Principal repayments 2005	83,763
Balance at December 31, 2005	\$ 34,989
New loans or disbursements 2006	735,072
Principal repayments 2006	630,044
Balance at December 31, 2006	\$ 140,017

Note 12. 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, 2006 and December 31, 2005, Santa Cruz County Bank's reserve requirement was \$876,000 and \$595,000, respectively.

As compensation for check clearing and other services, compensating balances of approximately \$10,000 were maintained with correspondent banks at December 31, 2006 and 2005. 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.

December 31, 2006 and 2005

Building Lease Commitments. The current operating lease for the Santa Cruz Office at 325 Soquel Avenue expires September 18, 2008, with an option to extend for three additional 5 year periods. The monthly lease payment for the Santa Cruz Office is presently \$8,969 plus 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 \$1,950 per month. Triple net expenses 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 years. Base rent for the initial term of the Watsonville lease is fixed at \$4,013 monthly plus triple net expenses. The lease for the administrative office at 340 Soquel Avenue, Suite 115 commenced on September 10, 2006, and expires September 30, 2007, with an option to extend for an additional 3 years. Base rent for the initial term is fixed at \$2,100 monthly plus triple net expenses. The rent was waived for the partial month period from September 10, 2006 through September 30, 2006.

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 years. Base rent for the initial term is fixed at \$5,076 monthly plus triple net expenses. The monthly base rent shall increase beginning with the first day of March, 2012. 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 Bank entered into a lease for the property located at 720 Front Street effective December 4, 2006 and will commence sixty days after the Landlord's Delivery of Possession, which is expected to be early 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 Front Street lease is fixed at \$17,280 monthly plus triple net expenses and adjusts every two years 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 increased to \$519 at its one year anniversary date. The operating lease 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 rental payments for future years under the three building leases and two kiosk leases are as follows at December 31, 2006:

December 31, 2006 and 2005

	cash				
2007	\$ 265,538				
2008	437,510				
2009	394,049				
2010	399,890				
2011	372,842				
Thereafter	1,895,197				
	\$ 3,765,026				

Building and kiosk rent expense for the year ended December 31, 2006 and December 31, 2005, was \$193,222 and \$172,731, 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 onbalance-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, 2006 and December 31, 2005 are as follows:

	 December 31,						
	 2006	2005					
Commitments to extend credit	\$ 40,477,061 \$	35,472,782					
Standby letters of credit	2,425,065	544,571					
	\$ 42,902,126 \$	36,017,353					

December 31, 2006 and 2005

Legal Matters. At December 31, 2006, the Bank was not subject to any claims and/or lawsuits.

Note 13. 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 14. 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, 2006 and December 31, 2005. 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,								
	2006					20			
		Amount		Value	Amount			Value	
Financial Assets:									
Cash and cash equivalents	\$	23,907,399	\$	23,907,399	\$	11,807,194	\$	11,807,194	
Securities available-for-sale		18,624,988		18,624,988		14,945,100		14,945,100	
Securities held-to-maturity		1,264,059		1,217,421		1,516,583		1,454,234	
Loans, net		81,017,571		80,897,784		63,564,601		63,045,672	
Bank owned life insurance		3,331,971		3,331,971		3,208,894		3,208,894	
Financial Liabilities:									
Noninterest-bearing demand deposits	\$	33,693,998	\$	33,693,998	\$	22,361,481	\$	22,361,481	
Interest-bearing demand deposits		6,382,888		6,382,888		6,285,261		6,285,261	
Money market accounts		40,150,201		40,150,201		34,367,104		34,367,104	
Time certificates of deposit		27,925,451		27,875,282		13,359,431		13,359,408	
Savings accounts		4,829,005		4,829,005		5,311,574		5,311,574	

December 31, 2006 and 2005

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, 2006 and December 31, 2005 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.

Note 15. Other Operating Income and Expense

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

	2006	2005
Other non-interest income:		
BOLI non-interest income	\$ 123,077	\$ 118,516
Gain on sale of loans	236,941	81,712
Other non-interest income	210,740	91,015
Total other non-interest income	\$ 570,758	\$ 291,243
Other non-interest expense:		
Stationery, supplies and printing	\$ 76,314	\$ 69,948
Armored car and messenger	84,552	52,623
Telephone, postage and electronic communications	59,642	49,162
Correspondent bank charges	72,512	47,291
Insurance and security	43,599	45,704
Loan and collection expense	41,706	37,497
ATM related expenses	64,540	30,441
Shareholder related expense	25,044	28,612
Regulatory assessments	35,368	23,584
Other non-interest expenses	167,488	105,488
Total other operating expenses	\$ 670,765	\$ 490,350

December 31, 2006 and 2005

Note 16. 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, 2006, the Bank met all capital adequacy requirements to which they were 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.

(Amount in thousands)	Actual			For Capital Adequacy Purposes:			For Regulatory Adequacy Purposes (first three years)			To Be Well Capitalized Under the FDICIA Prompt Corrective Action Provisions					
	_/	Amount	Ratio	Amount Ratio		Amount		Amount		Amount		Ratio		Amount	Ratio
As of December 31, 2006:															
Total capital (to risk weighted assets)	\$	19,313	17.80%	\$	8,678	8.00%	\$	10,847	10.00%	\$	10,847	10.00%			
Tier 1 capital (to risk weighted assets)	\$	18,037	16.63%	\$	4,339	4.00%	\$	6,508	6.00%	\$	6,508	6.00%			
Tier 1 capital (to average assets) leverage ratio	\$	18,037	14.08%	\$	5,126	4.00%	\$	10,251	8.00%	\$	6,407	5.00%			
As of December 31, 2005:															
Total capital (to risk weighted assets)	\$	16,337	19.75%	\$	6,616	8.00%	\$	8,270	10.00%	\$	8,270	10.00%			
Tier 1 capital (to risk weighted assets)	\$	15,497	18.74%	\$	3,308	4.00%	\$	4,962	6.00%	\$	4,962	6.00%			
Tier 1 capital (to average assets) leverage ratio	\$	15,497	16.40%	\$	3,780	4.00%	\$	7,561	8.00%	\$	4,726	5.00%			
As of December 31, 2004:															
Total capital (to risk weighted assets)	\$	11,350	27.56%	\$	3,295	8.00%	\$	4,119	10.00%	\$	4,119	10.00%			
Tier 1 capital (to risk weighted assets)	\$	10,943	26.57%	\$	1,648	4.00%	\$	2,471	6.00%	\$	2,471	6.00%			
Tier 1 capital (to average assets) leverage ratio	\$	10,943	25.08%	\$	1,745	4.00%	\$	3,490	8.00%	\$	2,181	5.00%			

December 31, 2006 and 2005

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. Throughout its first three years of operation, the Bank is required to maintain a Tier 1 Leverage Ratio of not less than 8%.

Note 17. Regulatory Matters

Under the terms of approval of deposit insurance by the Federal Deposit Insurance Corporation, the Bank's Tier 1 capital-to-assets leverage ratio (as defined in the appropriate capital regulation and guidance from the Bank's primary federal regulator) shall be maintained at not less than 8% throughout the first three years of operation. Additionally, the FDIC's approval requires that the Bank operate within the parameters of the business plan submitted as part of the Bank's application for deposit insurance during the first three years of operation and that any major deviation or material changes from the plan be submitted 60 days before consummating the change.

COMPANY INFORMATION

BOARD OF DIRECTORS



George R. Gallucci (Chairman) Director of Client Relations Scharf Investments



Tila Guerrero President & CEO MasMac, Inc. McDonald's Restaurants



William J. Hansen (Vice-Chairman) President and CEO Hansen Insurance Company



David V. Heald President & CEO Santa Cruz County Bank



Kenneth R. Chappell CPA, Partner-In-Charge Hutchinson & Bloodgood, LLP



Steven G. John President Ocean Honda



Thomas N. Griffin

Managing Attorney

Grunsky, Ebey, Farrar & Howell



Gary A. Reece President The ATC Group, Inc.

BANK ORGANIZERS

Richard Alderson, Joseph Anazlone, Victor Bogard, Anthony & Rebecca Campos, Charles Canfield, Kenneth Chappell, Kate & Fred Chen, Marshall Delk, George Gallucci, Thomas Griffin, Tila Guerrero, William J. Hansen, David Heald, Mark Holcomb, Steve John, Mateo Lettunich, Robert Lockwood, William Moncovich, Stuart Mumm, George Ow, Jr., Louis Rittenhouse, Frank Saveria, and Robert & Bjorg Yonts.

SANTA CRUZ COUNTY BANK MANAGEMENT TEAM

David V. Heald, *President & Chief Executive Officer*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*Donald H. Soman, *Senior Vice President & Chief Financial Officer*

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:

U.S. Stock Transfer Corporation 1745 Gardena Avenue Glendale, CA 91204-2991

Phone: 800.835.8778 Fax: 818.502.1737

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

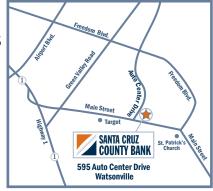
SANTA CRUZ

325 Soquel Ave. Santa Cruz, CA 95062 831.457.5000



WATSONVILLE

595 Auto Center Dr. Watsonville, CA 95076 831.761.7600



SCOTTS VALLEY

4604 Scotts Valley Dr. Scotts Valley, CA 95066 831.461.5000



CAPITOLA

819 Bay Ave, Ste D Capitola, CA 95010 831.464.5300



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 (At Dominican Hospital Campus)

APTOS

783-25 Rio Del Mar Blvd. Aptos, CA 95003 (At Deluxe Foods of Aptos)

www.sccountybank.com

831.457.5000





