

NORCAL COMMUNITY BANCORP AND SUBSIDIARY

CONSOLIDATED 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
NorCal Community Bancorp

We have audited the accompanying consolidated balance sheet of NorCal Community Bancorp and subsidiary as of December 31, 2008 and 2007 and the related consolidated statements of operations, changes in shareholders' equity and cash flows for each of the years in the three-year period ended December 31, 2008. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated 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 consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated 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 provided a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of NorCal Community Bancorp and subsidiary as of December 31, 2008 and 2007 and the consolidated results of their operations and their 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.

As more fully described in Note 3, the consolidated financial statements for 2008 have been restated.

Perry-Smith LLP

May 5, 2009

NORCAL COMMUNITY BANCORP AND SUBSIDIARY

CONSOLIDATED BALANCE SHEET

December 31, 2008 and 2007

	2008	2007
	(As Restated – See Note 3)	
ASSETS		
Cash and cash equivalents (Note 12)	\$ 4,257,366	\$ 4,251,492
Investment securities (fair value of \$14,529,000 in 2008 and \$19,492,000 in 2007) (Notes 5 and 9)	14,430,290	19,486,930
Loans and leases, less allowance for loan and lease losses of \$6,833,365 in 2008 and \$3,194,523 in 2007 (Notes 6, 9, 12 and 14)	233,365,526	244,673,003
Other real estate	1,069,616	
Premises and equipment, net (Note 7)	941,618	1,247,106
Federal Home Loan Bank stock	1,371,800	1,856,500
Accrued interest receivable and other assets (Note 11)	6,843,214	3,712,419
Total assets	\$ 262,279,430	\$ 275,227,450
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Non-interest bearing	\$ 47,329,457	\$ 58,945,412
Interest bearing (Note 8)	170,744,938	157,513,933
Total deposits	218,074,395	216,459,345
Short-term borrowings (Note 9)	11,000,000	22,000,000
Accrued interest payable and other liabilities	867,252	1,777,008
Subordinated debentures (Note 10)	8,248,000	8,248,000
Total liabilities	238,189,647	248,484,353
Commitments and contingencies (Note 12)		
Shareholders' equity (Note 13):		
Preferred stock - no par value; 10,000,000 shares authorized; no shares issued and outstanding in 2008 and 65,932 issued and outstanding in 2007		1,008,954
Common stock - no par value; 30,000,000 shares authorized; issued and outstanding 3,172,444 shares in 2008 and 3,043,791 shares in 2007	11,552,889	10,539,033
Retained earnings	12,501,624	15,169,534
Accumulated other comprehensive income, net of taxes (Notes 5 and 16)	35,270	25,576
Total shareholders' equity	24,089,783	26,743,097
Total liabilities and shareholders' equity	\$ 262,279,430	\$ 275,227,450

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

NORCAL COMMUNITY BANCORP AND SUBSIDIARY

CONSOLIDATED STATEMENT OF OPERATIONS

For the Years Ended December 31, 2008, 2007 and 2006

	2008	2007	2006
	(As Restated – See Note 3)		
Interest income:			
Interest and fees on loans and leases	\$ 17,514,523	\$ 19,898,849	\$ 17,300,591
Interest on Federal funds sold	35,635	36,127	222,480
Interest and dividends on investment securities:			
Taxable	666,164	957,023	812,461
Exempt from Federal income taxes	91,247	36,529	67,815
Total interest income	18,307,569	20,928,528	18,403,347
Interest expense:			
Interest on deposits (Note 8)	3,811,297	4,664,846	3,816,274
Interest on short-term borrowings (Note 9)	421,695	754,940	267,670
Interest on subordinated debentures (Note 10)	474,289	638,095	608,393
Total interest expense	4,707,281	6,057,881	4,692,337
Net interest income before provision for loan and lease losses	13,600,288	14,870,647	13,711,010
Provision for loan and lease losses (Note 6)	7,821,800	335,000	390,000
Net interest income after provision for loan and lease losses	5,778,488	14,535,647	13,321,010
Non-interest income:			
Service charges	478,695	316,081	325,216
Mortgage loan packaging fees	31,491	20,350	49,739
Other	346,816	382,417	391,192
Total non-interest income	857,002	718,848	766,147
Non-interest expenses:			
Salaries and employee benefits (Notes 6 and 17)	5,845,358	6,072,147	4,811,912
Occupancy and equipment (Notes 7 and 12)	1,827,321	1,790,843	1,470,037
Other expenses (Note 15)	3,335,993	2,743,931	2,270,897
Total non-interest expenses	11,008,672	10,606,921	8,552,846
(Loss) income before provision for income taxes	(4,373,182)	4,647,574	5,534,311
Provision for income tax (benefit) expense (Note 11)	(1,969,000)	1,774,000	2,191,000
Net (loss) income	\$ (2,404,182)	\$ 2,873,574	\$ 3,343,311
Basic (loss) earnings per share (Note 13)	\$ (0.88)	\$ 0.96	\$ 1.21
Diluted (loss) earnings per share (Note 13)	\$ (0.88)	\$ 0.87	\$ 1.07

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

NORCAL COMMUNITY BANCORP AND SUBSIDIARY
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
For the Years Ended December 31, 2008, 2007 and 2006

	<u>Preferred Stock</u>		<u>Common Stock</u>		<u>Retained Earnings</u> (As Restated – See Note 3)	<u>Accumulated Other Comprehensive (Loss) Income (Net of Taxes)</u>	<u>Total Shareholders' Equity</u> (As Restated – See Note 3)	<u>Total Comprehensive Income (Loss)</u> (As Restated – See Note 3)
	<u>Shares</u>	<u>Amount</u>	<u>Shares</u>	<u>Amount</u>				
Balance, January 1, 2006			2,587,803	\$ 7,621,754	\$ 8,952,649	\$ (130,541)	\$ 16,443,862	
Comprehensive income (Note 16):								
Net income					3,343,311		3,343,311	\$ 3,343,311
Other comprehensive income, net of taxes:								
Net change in unrealized losses on available-for-sale investment securities						82,928	82,928	<u>82,928</u>
Total comprehensive income								<u>\$ 3,426,239</u>
Restricted common stock awarded (Note 13)			67,237					
Stock options exercised, including tax benefits (Note 13)			273,563	2,260,418			2,260,418	
Fractional shares redeemed			(102)	(2,887)			(2,887)	
Repurchase of common stock under stock option plan			(5,250)	(93,275)			(93,275)	
Balance, December 31, 2006			2,923,251	9,786,010	12,295,960	(47,613)	22,034,357	
Comprehensive income (Note 16):								
Net income					2,873,574		2,873,574	\$ 2,873,574
Other comprehensive income, net of taxes:								
Net change in unrealized (losses) gains on available-for-sale investment securities						73,189	73,189	<u>73,189</u>
Total comprehensive income								<u>\$ 2,946,763</u>
Sale of preferred stock, net of offering costs of \$45,958 (Note 13)	65,932	\$ 1,008,954					1,008,954	
Restricted common stock awarded (Note 13)			9,910					
Restricted common stock forfeited			(2,213)					
Restricted common stock compensation expense (Note 13)				321,412			321,412	
Stock options exercised, including tax benefits (Note 13)			118,077	516,869			516,869	
Fractional shares redeemed				(303)			(303)	
Repurchase of common stock under stock option plan			(5,234)	(84,955)			(84,955)	
Balance, December 31, 2007	<u>65,932</u>	<u>\$ 1,008,954</u>	<u>3,043,791</u>	<u>\$ 10,539,033</u>	<u>\$ 15,169,534</u>	<u>\$ 25,576</u>	<u>\$ 26,743,097</u>	

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NORCAL COMMUNITY BANCORP AND SUBSIDIARY
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
(Continued)
For the Years Ended December 31, 2008, 2007 and 2006

	<u>Preferred Stock</u>		<u>Common Stock</u>		<u>Retained Earnings</u> (As Restated – See Note 3)	<u>Accumulated Other Comprehensive (Loss) Income (Net of Taxes)</u>	<u>Total Shareholders' Equity</u> (As Restated – See Note 3)	<u>Total Comprehensive Income (Loss)</u> (As Restated – See Note 3)
	<u>Shares</u>	<u>Amount</u>	<u>Shares</u>	<u>Amount</u>				
Balance, December 31, 2007	65,932	\$ 1,008,954	3,043,791	\$ 10,539,033	\$ 15,169,534	\$ 25,576	\$ 26,743,097	
Comprehensive loss (Note 16):								
Net loss – as restated, see Note 3					(2,404,182)		(2,404,182)	\$ (2,404,182)
Other comprehensive income, net of taxes:								
Net change in unrealized gain on available-for-sale investment securities (Note 5)						9,694	9,694	<u>9,694</u>
Total comprehensive loss								<u>\$ (2,394,488)</u>
Preferred stock beneficial conversion feature (Note 13)	16,483	263,728			(263,728)			
Conversion of preferred stock with a conversion factor of 1.25 into common stock	(82,415)	(1,272,682)	82,415	1,272,682				
Restricted common stock compensation expense (Note 13)					341,061		341,061	
Stock options exercised, including tax benefits (Note 13)			107,392	275,181			275,181	
Repurchase of common stock under stock option plan (Note 13)			(26,154)	(320,568)			(320,568)	
Repurchase of common stock (Note 13)			(35,000)	(554,500)			(554,500)	
Balance, December 31, 2008	<u>-</u>	<u>\$ -</u>	<u>3,172,444</u>	<u>\$ 11,552,889</u>	<u>\$ 12,501,624</u>	<u>\$ 35,270</u>	<u>\$ 24,089,783</u>	

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

NORCAL COMMUNITY BANCORP AND SUBSIDIARY

CONSOLIDATED STATEMENT OF CASH FLOWS

For the Years Ended December 31, 2008, 2007 and 2006

	<u>2008</u>	<u>2007</u>	<u>2006</u>
	(As Restated – See Note 3)		
Cash flows from operating activities:			
Net (loss) income	\$ (2,404,182)	\$ 2,873,574	\$ 3,343,311
Adjustments to reconcile net (loss) income to net cash provided by operating activities:			
Provision for loan and lease losses	7,821,800	335,000	390,000
Restricted common stock compensation expense	341,061	321,412	
Tax benefit from exercise of stock options	(67,579)	(287,359)	(1,267,603)
Depreciation and amortization	578,849	485,658	375,934
Federal Home Loan Bank stock dividends	(76,800)	(53,600)	(48,500)
(Gain) loss on sales of premises and equipment	(497)	7,429	6,102
Other real estate impairment	439,397		
(Decrease) increase in deferred loan origination fees, net	(225,180)	63,080	97,206
Return on investment in NorCal Community Bancorp Trusts I and II	(14,658)	(19,112)	(18,368)
(Increase) decrease in accrued interest receivable and other assets	(1,429,294)	(42,518)	1,040,104
(Decrease) increase in accrued interest payable and other liabilities	(909,756)	250,919	197,619
Provision for deferred income taxes	<u>(1,626,000)</u>	<u>(200,000)</u>	<u>(187,000)</u>
Net cash provided by operating activities	<u>2,427,161</u>	<u>3,734,483</u>	<u>3,928,805</u>
Cash flows from investing activities:			
Proceeds from sales and calls of available-for-sale investment securities	11,005,000	8,055,000	1,335,000
Proceeds from matured available-for-sale investment securities	750,000	5,300,000	5,110,000
Proceeds from called held-to-maturity investment securities	1,555,000	150,000	1,520,000
Proceeds from matured held-to-maturity investment securities	3,920,000	2,035,000	890,000
Purchases of available-for-sale investment securities	(6,026,923)	(13,957,740)	(5,497,581)
Purchases of held-to-maturity investment securities	(6,207,147)		(508,245)
FHLB stock redemptions (purchases), net	561,500	(810,600)	(4,700)
Net decrease (increase) in loans and leases	2,201,844	(33,693,778)	(26,049,808)
Proceeds from sales of premises and equipment	650	1,500	4,700
Purchases of premises and equipment	(196,374)	(552,883)	(1,000,763)
Investment in NorCal Community Bancorp Trust II			<u>(124,000)</u>
Net cash provided by (used in) investing activities	<u>7,563,550</u>	<u>(33,473,501)</u>	<u>(24,325,397)</u>

(Continued)

NORCAL COMMUNITY BANCORP AND SUBSIDIARY
CONSOLIDATED STATEMENT OF CASH FLOWS
(Continued)
For the Years Ended December 31, 2008, 2007 and 2006

	<u>2008</u>	<u>2007</u>	<u>2006</u>
	(As Restated – See Note 3)		
Cash flows from financing activities:			
Net (decrease) increase in demand, interest bearing and savings deposits	\$ (6,736,654)	\$ (18,175,112)	\$ 12,916,991
Net increase in time deposits	8,351,704	7,629,778	5,878,593
Net (decrease) increase in short-term borrowings	(11,000,000)	20,000,000	2,000,000
Proceeds from issuance of subordinated debentures			4,124,000
Proceeds from issuance of preferred stock, net of offering costs		1,008,954	
Cash paid for fractional shares		(303)	(2,887)
Repurchase of common stock	(875,068)	(84,955)	(93,275)
Proceeds from exercise of stock options	207,602	229,510	992,815
Tax benefit from exercise of stock options	<u>67,579</u>	<u>287,359</u>	<u>1,267,603</u>
Net cash (used in) provided by financing activities	<u>(9,984,837)</u>	<u>10,895,231</u>	<u>27,083,840</u>
Increase (decrease) in cash and cash equivalents	5,874	(18,843,787)	6,687,248
Cash and cash equivalents, beginning of year	<u>4,251,492</u>	<u>23,095,279</u>	<u>16,408,031</u>
Cash and cash equivalents, end of year	<u>\$ 4,257,366</u>	<u>\$ 4,251,492</u>	<u>\$ 23,095,279</u>
Supplemental disclosure of cash flow information:			
Cash paid during the year for:			
Interest expense	\$ 4,874,055	\$ 5,982,427	\$ 4,569,788
Income taxes	\$ 1,298,000	\$ 1,710,000	\$ 1,290,000
Non-cash investing and financing activities:			
Transfer of loans held for investment to other real estate	\$ 1,509,013		
Net change in unrealized gains (losses) on available-for-sale investment securities	\$ 16,430	\$ 123,866	\$ 140,636

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

NORCAL COMMUNITY BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. THE BUSINESS OF NORCAL COMMUNITY BANCORP

General

During 2001, NorCal Community Bancorp (the "Company") was incorporated as a bank holding company for the purpose of acquiring Bank of Alameda and to provide the Company and the Bank greater flexibility for expansion and diversification. On September 22, 2003 and December 29, 2005, the Company formed NorCal Community Bancorp Trusts I and II, respectively, (the "Trusts"), for the sole purpose of issuing trust preferred securities.

The Bank operates seven offices in its primary service area of Alameda County, three branches in the city of Alameda, two commercial banking offices located in Emeryville and Oakland and administrative offices located in Walnut Creek and Alameda. The Bank's primary business is serving the commercial banking needs of small to mid-sized businesses.

The Bank is participating in the FDIC's Transaction Account Guarantee Program. Under that program, through December 31, 2009, all noninterest-bearing transaction accounts are fully guaranteed by the FDIC for the entire amount in the account. Coverage under the Transaction Account Guarantee Program is in addition to and separate from the coverage available under the FDIC's general deposit insurance rules.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting and reporting policies of NorCal Community Bancorp and subsidiary conform with accounting principles generally accepted in the United States of America and prevailing practices within the banking industry.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and the accounts of its wholly-owned subsidiary, the Bank. All significant intercompany balances and transactions have been eliminated.

NorCal Community Bancorp Trusts I and II are not consolidated into the Company's consolidated financial statements and, accordingly, are accounted for under the equity method. The subordinated debentures issued and guaranteed by the Company and held by the Trusts are reflected on the Company's consolidated balance sheet.

Cash and Cash Equivalents

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

NORCAL COMMUNITY BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Investment Securities

Investments are classified into the following categories:

- Available-for-sale securities, reported at fair value, with unrealized gains and losses excluded from earnings and reported, net of income 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.

Management determines the appropriate classification of its investment securities 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. In addition, unrealized losses that are other-than-temporary are recognized in earnings for all investments.

Investment securities are evaluated for other-than-temporary impairment on at least a quarterly basis 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 Company to retain its investment in the instruments 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.

Federal Home Loan Bank Stock

The investment in Federal Home Loan Bank (FHLB) stock is carried at cost and is redeemable at par with certain restrictions. Investment in FHLB stock is required to participate in FHLB programs.

NORCAL COMMUNITY BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Loans and Leases

Loans and leases are reported at the principal amounts outstanding, adjusted for unearned income, deferred loan origination fees and costs, purchase premiums and discounts, write-downs and the allowance for loan and lease losses. Loan and lease origination fees, net of certain deferred origination costs, and purchase premiums and discounts are recognized as an adjustment to the yield of the related loans and leases.

A loan is considered impaired when, based on current information and events, it is probable that all amounts due (including both principal and interest) will not be collected 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.

The accrual of interest on loans and leases is discontinued when, in the opinion of management, there is an indication that the borrower may be unable to meet payments as they become due. Upon such discontinuance, all unpaid accrued interest is reversed against current income unless the loan or lease is in the process of collection. Interest received on nonaccrual loans and leases is either applied against principal or reported as interest income, according to management's judgment as to the collectibility of principal. Generally, loans and leases are restored to accrual status when the obligation is brought current and has performed in accordance with the contractual terms for a reasonable period of time and the ultimate collectibility of the total contractual principal and interest is no longer in doubt.

Direct financing leases are carried net of unearned income. Income from leases is recognized by a method that approximates a level yield on the outstanding net investment in the lease.

Loan Sales and Servicing

Included in the portfolio are Small Business Administration (SBA) guaranteed loans that may be sold in the secondary market. 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 that the purchasers have committed to purchase the loans. At the time the loan is sold, the related right to service the loan is recorded at fair value with the Company earning future servicing income. Gains and losses are recognized at the time of sale and are calculated based on the difference between the selling price and the fair value of servicing assets or liabilities and the allocated carrying value of the loans sold. At December 31, 2008 and 2007, there were no loans designated as held for sale.

Loans held for sale subsequently transferred to the loan portfolio are transferred at the lower of cost or market value at the date of transfer. Any difference between the carrying amount of the loan and its outstanding principal balance is recognized as an adjustment to yield by the interest method.

NORCAL COMMUNITY BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Loan Sales and Servicing (Continued)

SBA loans with unpaid balances of \$3,108,115 and \$3,421,210 were being serviced for others at December 31, 2008 and 2007, respectively.

Servicing rights acquired through 1) a purchase or 2) the origination of loans which are sold or securitized 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. Servicing assets were not considered material for disclosure purposes.

Allowance for Loan and Lease Losses

The allowance for loan and lease losses is maintained to provide for losses related to impaired loans and leases 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 composition of the loan and lease portfolio, specifically identified problem loans and leases, potential losses inherent in the portfolio taken as a whole and economic conditions in the Company's service area.

Loans and leases determined to be impaired are individually evaluated by management for specific risk of loss. In addition, reserve factors are assigned to currently performing loans and leases based on management's assessment of the following for each identified loan and lease type: (1) inherent credit risk, (2) historical losses and, (3) where the Company has not experienced losses, the loss experience of peer banks. Management also computes expected loss reserves for loan commitments. These estimates are particularly susceptible to changes in the economic environment and market conditions.

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

The allowance is established through a provision for loan and lease losses which is charged to expense. Additions to the allowance are expected to maintain the adequacy of the total allowance after credit losses and loan and lease growth. The allowance for loan and lease losses at December 31, 2008 and 2007, respectively, reflects management's estimate of possible losses in the portfolio. Although management believes the allowance for loan and lease losses to be adequate, ultimate losses may vary from their estimates. In addition, the FDIC and California Department of Financial Institutions (DFI), as an integral part of their examination process, review the allowance for loan and lease losses. These agencies may require additions to the allowance for loan and lease losses based on their judgment about information available at the time of their examination.

NORCAL COMMUNITY BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Other Real Estate

Other real estate is comprised of property acquired through foreclosure proceedings or acceptance of deeds-in-lieu of foreclosure. Losses recognized at the time of acquiring property in full or partial satisfaction of debt are charged against the allowance for loan losses. Other real estate is recorded at the lower of the related loan balance or fair value, less estimated disposition costs. Fair value of other real estate is generally based on an independent appraisal of the property. Revenues and expenses associated with other real estate, and subsequent adjustments to the fair value of the property and to the estimated costs of disposal, are realized and reported as a component of noninterest expense when incurred.

Premises and Equipment

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 two to five years. Leasehold improvements are amortized over the life of the asset or the term of the related lease, whichever is shorter. When assets are sold or otherwise disposed of, the cost and related accumulated depreciation or amortization are removed from the accounts, and any resulting gain or loss is recognized in income for the period. The cost of maintenance and repairs is charged to expense as incurred. Management evaluates premises and equipment for financial impairment as events or changes in circumstances indicate that the carrying amount of such assets may not be fully recoverable.

Income Taxes

The Company files its income taxes on a consolidated basis with its subsidiary. The allocation of income tax expense (benefit) represents each entity's proportionate share of the consolidated provision for income taxes.

Deferred tax assets and liabilities are recognized for the tax consequences of temporary differences between the financial statement and tax basis 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. On the consolidated balance sheet, net deferred tax assets are included in accrued interest receivable and other assets.

Under Financial Accounting Standards Board (FASB) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48), the Company measures income tax positions taken or expected to be taken in a tax return for financial statement recognition and measurement. The provisions of FIN 48 have been applied to all tax positions of the Company as of January 1, 2007. Only tax positions that met the more-likely-than-not recognition threshold on January 1, 2007 were recognized or continue to be recognized upon adoption. The Company previously recognized income tax positions based on management's estimate of whether it was reasonably possible that a liability has been incurred for unrecognized income tax benefits by applying FASB Statement No. 5, *Accounting for Contingencies*. The adoption of FIN 48 did not have a material impact on the Company's financial position or operations.

NORCAL COMMUNITY BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Earnings (Loss) Per Share

Basic earnings (loss) per share (EPS), which excludes dilution, is computed by dividing income (loss) 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, restricted stock and converted preferred stock result in the issuance of common stock which shares in the earnings (loss) of the Company. The treasury stock method has been applied to determine the dilutive effect of stock options and restricted stock in computing diluted EPS. EPS is retroactively adjusted for stock splits for all periods presented.

Share-Based Compensation

In 1998 the Board of Directors of Bank of Alameda adopted, and in 1999 the Bank's shareholders approved, the Bank of Alameda 1998 Stock option Plan (1998 Plan). In January 2002, following the organization of NorCal Community Bancorp as the holding company for Bank of Alameda, the 1998 Plan was restated and adopted by NorCal Community Bancorp as the successor corporation to Bank of Alameda. In 2006 the Company's shareholders approved and amendment to the Plan and the Plan was renamed the Amended and Restated 1998 Equity Incentive Plan. The 1998 Plan expired on May 3, 2008. When the 1998 Plan expired, approximately 176,783 unexercised stock options issued pursuant to the 1998 Plan, equal to approximately six percent of the total number of shares of NorCal Community Bancorp common stock, were outstanding.

To replace the 1998 Plan, the Board of Directors adopted and the shareholders approved the NorCal Community Bancorp 2008 Equity Incentive Plan (Incentive Plan). The Incentive Plan provides for the following types of awards: stock options, restricted stock awards, qualified performance-based awards and stock grants. Subject to certain adjustments, the maximum aggregate number of shares of the Company's common stock which may be issued subject to awards is 400,000. As of December 31, 2008 no awards have been granted under this Plan.

Restricted stock awards are grants of shares of common stock that are subject to forfeiture upon termination of employment. Compensation expense is recognized over the vesting period based on the fair market value of the Company's common stock on the date of grant. During the period of restriction, participants holding restricted stock have the right to vote and the right to receive dividends. The restrictions lapse in accordance with a schedule or with other conditions determined by the Compensation Committee.

NORCAL COMMUNITY BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Share-Based Compensation (Continued)

The Company is required to measure the cost of employee services received in exchange for an award of equity instruments based on the grant date fair value of the award. Management estimates the fair value of each option award as of the date of grant using a Black-Scholes-Merton option pricing model. Expected volatility is based on the historical volatility of the Company's common stock. The expected term represents the period that the stock-based awards are expected to be outstanding. The risk free interest rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of grant. The expected dividend yield was not considered in the option pricing formula because the Company has not paid cash dividends historically and had no plans to do so at the grant date. In addition to these assumptions, management makes estimates regarding pre-vesting forfeitures that will impact total compensation expense recognized under the Plan.

No options were granted during the years ended December 31, 2008, 2007 and 2006.

In October 2005, the Company accelerated the vesting of all previously unvested stock options granted to directors and employees. The stock options affected by the acceleration represented 15% of the outstanding stock options awarded at that date. An adjustment to compensation expense may be required if such directors and employees leave the Company prior to the original vesting date of the related options.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions. 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.

Reclassifications

Certain balances in the consolidated financial statements have been reclassified to conform with the current year presentation.

NORCAL COMMUNITY BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Fair Value Option for Financial Assets and Financial Liabilities

In February 2007, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS No. 159). SFAS No. 159 permits fair value accounting to be irrevocably elected for certain financial assets and liabilities at the time of acquisition on an individual contract basis or at a remeasurement event date. The standard also establishes presentation and disclosure requirements designed to facilitate comparison between entities that choose different measurement attributes for similar types of assets and liabilities. The Bank adopted SFAS No. 159 on January 1, 2008, but did not elect the fair value option for any assets or liabilities for the year ended December 31, 2008.

Impact of New Financial Accounting Standards

Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active

In October 2008, the FASB issued FASB Staff Position (FSP) FAS 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active*. The FSP clarifies the application of FASB Statement No. 157, Fair Value Measurements, in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. The FSP was effective immediately, and includes prior period financial statements that have not yet been issued. Therefore the Company was subject to the provisions of the FSP effective immediately. The impact of adoption was not material to the Company's financial condition or results of operations.

Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly

In April 2009, the FASB issued FSP FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*, which provides additional guidance for estimating fair value in accordance with SFAS No. 157 when the volume and level of activity of the asset or liability have decreased significantly. FSP FAS 157-4 also provides guidance on identifying circumstances that indicate a transaction is not orderly. The provisions of FSP FAS 157-4 are effective for years ending after June 15, 2009. Management is currently evaluating the effect that the provisions of FSP FAS 157-4 may have on the Company's financial position or results of operations.

NORCAL COMMUNITY BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Impact of New Financial Accounting Standards (Continued)

Recognition and Presentation of Other-Than-Temporary Impairments

In April 2009, the FASB issued FSP FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*. The FSP amends current other-than-temporary impairment guidance in generally accepted accounting principles for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities in the financial statements. This FSP does not amend existing recognition and measurement guidance related to other-than-temporary impairments of equity securities. The provisions of FSP FAS 115-2 and FAS 124-2 are effective for years ending after June 15, 2009. Management is currently evaluating the effect that the provisions of FSP FAS 115-2 and FAS 124-2 may have on the Company's financial position or results of operations.

Business Combinations

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

Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies

In April 2009, the FASB issued FSP FAS 141(R)-1, *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies*. This FSP amends and clarifies FASB Statement No. 141 (revised 2007), *Business Combinations*, to address application issues raised on initial recognition and measurement, subsequent measurement and accounting, and disclosure of assets and liabilities arising from contingencies in a business combination. The provisions of this FSP are effective for assets or liabilities arising from contingencies in business combinations for which the acquisition date is on or after January 1, 2009. This FSP is not expected to have a material impact on the Company's financial position or results of operations.

NORCAL COMMUNITY BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

3. RESTATEMENT OF CONSOLIDATED FINANCIAL STATEMENTS

In April 2009, in response to an examination by the Bank's regulators, management re-examined its loan portfolio and other real estate. Management determined that an additional provision for loan and lease losses and impairment charge on other real estate of approximately \$4,300,000 and \$460,000, respectively, including loan charge-offs of approximately \$2,200,000, should have been reflected in the December 31, 2008 consolidated financial statements. The adjustments resulted from a decline in value confirmed by appraisals on real property serving as collateral for the loans and other real estate and the related impact on qualitative factors affecting the Bank's general loan and lease loss reserves.

In addition to the adjustments previously noted, certain fraudulent activity that had been initiated by a bank employee in 2008 and continued into 2009, was discovered in April 2009. Total deposits have been increased from previously reported amounts by approximately \$564,000, representing the restoration of the misappropriated funds with an increase in receivables of \$514,000, representing the anticipated insurance recovery. A charge to other expenses of \$50,000 reflecting the deductible portion of the loss has also been recorded for the year ended December 31, 2008.

The after tax effect of these adjustments was to decrease previously reported net income for the year ended December 31, 2008 by approximately \$2,818,000.

The following table presents the effect of the correction on each financial statement line item in the consolidated balance sheet and consolidated statement of operations for the year ended December 31, 2008:

	<u>As of December 31, 2008</u>		
	<u>As Previously Reported</u>	<u>Adjustment</u>	<u>As Restated</u>
Selected Balance Sheet Accounts:			
Loans and leases, less allowance for loan and lease losses	\$ 237,665,526	\$ (4,300,000)	\$ 233,365,526
Allowance for loan and lease losses	\$ 4,723,613	\$ 2,109,752	\$ 6,833,365
Other real estate	\$ 1,509,013	\$ (439,397)	\$ 1,069,616
Accrued interest receivable and other assets	\$ 4,358,660	\$ 2,484,554	\$ 6,843,214
Deposits	\$ 217,510,895	\$ 563,500	\$ 218,074,395
Retained earnings	\$ 15,319,967	\$ (2,818,343)	\$ 12,501,624
	<u>For the Year Ended December 31, 2008</u>		
	<u>As Previously Reported</u>	<u>Adjustment</u>	<u>As Restated</u>
Selected Statement of Operations Accounts and Earnings (Loss) Per Share:			
Provision for loan and lease losses	\$ 3,521,800	\$ 4,300,000	\$ 7,821,800
Other expenses	\$ 2,846,650	\$ 489,343	\$ 3,335,993
Provision for income tax (benefit) expense	\$ 2,000	\$ (1,971,000)	\$ (1,969,000)
Net income (loss)	\$ 414,161	\$ (2,818,343)	\$ (2,404,182)
Basic earnings (loss) per share	\$ 0.05	\$ (0.93)	\$ (0.88)
Diluted earnings (loss) per share	\$ 0.05	\$ (0.93)	\$ (0.88)

NORCAL COMMUNITY BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

3. RESTATEMENT OF CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Comprehensive income as originally reported of \$423,855 for the year ended December 31, 2008 was restated by \$2,818,343 to be a comprehensive loss of \$2,394,488. In addition, in the statement of cash flows, net cash flows provided by operating activities decreased by \$563,500 to \$2,427,181 and net cash used in financing activities decreased by \$563,000 to \$9,984,837 as a result of the restatement for the year ended December 31, 2008.

4. FAIR VALUE MEASUREMENTS

Fair Value of Financial Instruments

The estimated carrying and fair values of the Company's financial instruments are as follows:

	<u>December 31, 2008</u>		<u>December 31, 2007</u>	
	<u>Carrying Amount</u>	<u>Fair Value</u>	<u>Carrying Amount</u>	<u>Fair Value</u>
Financial assets:				
Cash and cash equivalents	\$ 4,257,366	\$ 4,257,366	\$ 4,251,492	\$ 4,251,492
Investment securities	14,430,290	14,529,000	19,486,930	19,492,000
Loans and leases, net	233,365,526	243,203,000	244,673,003	251,858,000
Federal Home Loan Bank (FHLB) stock	1,371,800	1,371,800	1,856,500	1,856,500
Accrued interest receivable	1,194,811	1,194,811	1,616,651	1,616,651
Financial liabilities:				
Deposits	218,074,395	218,564,500	216,459,345	216,833,000
Accrued interest payable	302,292	302,292	469,066	469,066
Short-term borrowings	11,000,000	11,000,000	22,000,000	22,000,000
Subordinated debentures	8,248,000	3,065,369	8,248,000	7,956,000

These estimates do not reflect any premium or discount that could result from offering the Company'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.

NORCAL COMMUNITY BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

4. FAIR VALUE MEASUREMENTS (Continued)

Fair Value of Financial Instruments (Continued)

The following methods and assumptions were used to estimate the fair value of financial instruments. For cash and cash equivalents, variable-rate loans and leases, accrued interest receivable and payable, FHLB stock, demand deposits and short-term borrowings, the carrying amount is estimated to be fair value. For investment securities, fair values are based on quoted market prices, quoted market prices for similar securities and indications of value provided by brokers. The fair values for fixed-rate loans and leases are estimated using discounted cash flow analyses, using interest rates currently being offered at each reporting date for loans with similar terms to borrowers of comparable creditworthiness. 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 Company for certificates with similar remaining maturities. The fair value of subordinated debentures is based on an indication of value provided by a third-party broker. The fair values of commitments are estimated using the fees currently charged to enter into similar agreements and are not significant and, therefore, not included in the above table.

Fair Value Measurements Under SFAS 157

On January 1, 2008, the Bank adopted Financial Accounting Standards Board (FASB) Statement No. 157 (SFAS 157), *Fair Value Measurements*. SFAS No. 157 defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles, and expands disclosures about fair value measurement. Upon adoption of SFAS No. 157, there was no cumulative effect adjustment to beginning retained earnings and no impact on the consolidated financial statements.

Fair Value Hierarchy

In accordance with SFAS No. 157, the Company groups its assets and liabilities measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. Valuations within these levels are based upon:

Level 1 – Quoted market prices for identical instruments traded in active exchange markets.

Level 2 – Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable or can be corroborated by observable market data.

Level 3 – Model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect the Company's estimates of assumptions that market participants would use on pricing the asset or liability. Valuation techniques include management judgment and estimation which may be significant.

NORCAL COMMUNITY BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

4. FAIR VALUE MEASUREMENTS (Continued)

Fair Value Measurements Under SFAS 157 (Continued)

Assets Recorded at Fair Value

The following tables present information about the Company's assets and liabilities measured at fair value on a recurring and nonrecurring basis as of December 31, 2008:

Recurring Basis

The Company is required or permitted to record the following assets at fair value on a recurring basis under other accounting pronouncements.

<u>Description</u>	<u>Fair Value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Investment securities available-for-sale	<u>\$ 7,793,000</u>	<u>\$ -</u>	<u>\$ 7,793,000</u>	<u>\$ -</u>

Fair values for available-for-sale investment securities, which include debt securities of U.S. Governmental agencies and obligations of states and political subdivisions, are based on quoted market prices for similar securities.

Non-recurring Basis

The Company may be required, from time to time, to measure certain assets at fair value on a non-recurring basis. These include assets that are measured at the lower of cost or market value that were recognized at fair value which was below cost at the reporting date.

<u>Description</u>	<u>Fair Value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Impaired loans	\$ 13,103,989			\$ 13,103,989
Other real estate	<u>1,069,616</u>			<u>1,069,616</u>
Total assets measured at fair value on a non- recurring basis	<u>\$14,173,605</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$14,173,605</u>

The following methods were used to estimate the fair value of each class of assets above:

Impaired Loans – The fair value of impaired loans is based on the fair value of the collateral for all collateral dependent loans. Impaired loans were determined to be collateral dependent and categorized as Level 3 due to ongoing real estate market conditions resulting in inactive market data, which in turn required the use of unobservable inputs and assumptions in fair value measurements.

NORCAL COMMUNITY BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

4. FAIR VALUE MEASUREMENTS (Continued)

Fair Value Measurements Under SFAS 157 (Continued)

Assets Recorded at Fair Value (Continued)

Non-recurring Basis (Continued)

Other Real Estate – The fair value of other real estate is based on the values obtained through property appraisals, which can include observable and unobservable inputs. Other real estate fair values were categorized as Level 3 due to ongoing real estate market conditions resulting in inactive market data, which in turn required the use of unobservable inputs and assumptions in fair value measurements.

5. INVESTMENT SECURITIES

Available-for-Sale

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

	2008			Estimated
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Debt securities:				
U.S. Government agencies	\$ 5,963,220	\$ 75,780		\$ 6,039,000
Obligations of states and political subdivisions	1,770,000	3,880	\$ (19,880)	1,754,000
	\$ 7,733,220	\$ 79,660	\$ (19,880)	\$ 7,793,000

Net unrealized gains on available-for-sale investment securities totaling \$59,780 were recorded, net of \$24,510 in tax expense, as accumulated other comprehensive gain within shareholders' equity at December 31, 2008. Proceeds from sales and calls of available-for-sale investment securities for the year ended December 31, 2008 totaled \$11,005,000. There were no realized gains or losses on sales and calls of available-for-sale investment securities for the year ended December 31, 2008.

	2007			Estimated
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Debt securities:				
U.S. Government agencies	\$ 11,952,334	\$ 43,018	\$ (2,352)	\$ 11,993,000
Obligations of states and political subdivisions	1,550,316	6,200	(3,516)	1,553,000
	\$ 13,502,650	\$ 49,218	\$ (5,868)	\$ 13,546,000

NORCAL COMMUNITY BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

5. INVESTMENT SECURITIES (Continued)

Available-for-Sale (Continued)

Net unrealized gains on available-for-sale investment securities totaling \$43,350 were recorded, net of \$17,774 in tax expense, as accumulated other comprehensive gain within shareholders' equity at December 31, 2007. Proceeds from sales and calls of available-for-sale investment securities for the year ended December 31, 2007 totaled \$8,055,000. There were no realized gains or losses on sales and calls of available-for-sale investment securities for the years ended December 31, 2007 and 2006.

Held-to-Maturity

	2008			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Government agencies	\$ 6,637,290	\$ 115,983	\$ (17,273)	\$ 6,736,000
	2007			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Government agencies	\$ 3,593,577	\$ 2,695	\$ (1,272)	\$ 3,595,000
Obligations of states and political subdivisions	2,347,353	5,514	(1,867)	2,351,000
	<u>\$ 5,940,930</u>	<u>\$ 8,209</u>	<u>\$ (3,139)</u>	<u>\$ 5,946,000</u>

During 2008, 2007 and 2006, there were no sales or transfers of held-to-maturity investment securities.

Investment securities with unrealized losses at December 31, 2008 and 2007 are summarized and classified according to the duration of the loss period as follows:

	2008					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<u>Available-for-Sale</u>						
Debt securities:						
Obligations of states and political sub- divisions	\$ 750,000	\$ (19,880)	\$ -	\$ -	\$ 750,000	\$ (19,880)
<u>Held-to-Maturity</u>						
Obligations of states and political sub- divisions	\$ 1,855,000	\$ (17,273)	\$ -	\$ -	\$ 1,855,000	\$ (17,273)

NORCAL COMMUNITY BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

5. INVESTMENT SECURITIES (Continued)

	2007					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<u>Available-for-Sale</u>						
Debt securities:						
U.S. Government agencies	\$ 498,000	\$ (75)	\$ 1,000,000	\$ (2,277)	\$ 1,498,000	\$ (2,352)
Obligations of states and political sub-divisions			550,000	(3,516)	550,000	(3,516)
	\$ 498,000	\$ (75)	\$ 1,550,000	\$ (5,793)	\$ 2,048,000	\$ (5,868)
<u>Held-to-Maturity</u>						
Debt securities:						
U.S. Government agencies	\$ 999,000	\$ (491)	\$ 500,000	\$ (781)	\$ 1,499,000	\$ (1,272)
Obligations of states and political sub-divisions	725,000	(1,470)	200,000	(397)	925,000	(1,867)
	\$ 1,724,000	\$ (1,961)	\$ 700,000	\$ (1,178)	\$ 2,424,000	\$ (3,139)

At December 31, 2008, the Company held 35 investment securities, none of which were in a loss position for more than twelve months.

Securities of U.S. Government Agencies

Management believes that the unrealized losses on the Company's investments in securities of U.S. Government agencies is caused by interest rate fluctuations and is not attributable to changes in credit quality. Additionally, the contractual cash flows of these investments are guaranteed by an agency of the U.S. Government. Management intends to hold these investments until at least a recovery of fair value or until maturity. Management does not consider these investments to be other-than-temporarily impaired at December 31, 2008.

Obligations of States and Political Subdivisions

Management believes that the unrealized losses on the Company's investments in obligations of states and political subdivisions is caused by interest rate fluctuations and is not attributable to changes in credit quality. Additionally, the contractual cash flows of these investments are a general obligation of, and supported by specific revenues of, a state or local municipality and the Company intends to hold these investments to maturity or call. Therefore, management expects to collect all amounts due and does not consider these securities to be other-than-temporarily impaired at December 31, 2008.

NORCAL COMMUNITY BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

5. INVESTMENT SECURITIES (Continued)

The amortized cost and estimated fair value of investment securities at December 31, 2008 by contractual maturity are shown below. Expected maturities will differ from contractual maturities because the issuers of the securities may have the right to call or prepay obligations with or without call or prepayment penalties.

	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Within one year			\$ 110,000	\$ 111,000
After one year				
through five years	\$ 6,733,220	\$ 6,789,000	5,853,408	5,925,000
After five years				
through ten years			673,882	700,000
After ten years	<u>1,000,000</u>	<u>1,004,000</u>		
	<u>\$ 7,733,220</u>	<u>\$ 7,793,000</u>	<u>\$ 6,637,290</u>	<u>\$ 6,736,000</u>

Investment securities with amortized costs of \$12,882,226 and \$18,122,795 and estimated fair values of \$13,017,000 and \$18,169,000 were pledged to secure treasury, tax and loan accounts and borrowing arrangements at December 31, 2008 and 2007, respectively (see Note 9).

6. LOANS AND LEASES

Outstanding loans and leases are summarized below:

	December 31,	
	2008	2007
Commercial	\$ 25,018,486	\$ 29,808,857
Agricultural	20,166,328	21,525,125
Real estate – residential	24,856,659	22,079,104
Real estate – commercial	80,701,269	96,470,580
Real estate – construction	75,440,156	66,903,147
Consumer	14,083,069	11,112,789
Leases	<u>579,451</u>	<u>839,631</u>
	240,845,418	248,739,233
Deferred loan origination fees, net	(646,527)	(871,707)
Allowance for loan and lease losses	<u>(6,833,365)</u>	<u>(3,194,523)</u>
	<u>\$ 233,365,526</u>	<u>\$ 244,673,003</u>

NORCAL COMMUNITY BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

6. LOANS AND LEASES (Continued)

Certain loans have been pledged to secure borrowing arrangements (see Note 8).

Changes in the allowance for loan and lease losses were as follows:

	<u>Year Ended December 31,</u>		
	<u>2008</u>	<u>2007</u>	<u>2006</u>
Balance, beginning of year	\$ 3,194,523	\$ 2,885,421	\$ 2,472,156
Provision charged to operations	7,821,800	335,000	390,000
Losses charged to allowance	(4,192,434)	(27,276)	(12,681)
Recoveries of loans previously charged off	<u>9,476</u>	<u>1,378</u>	<u>35,946</u>
Balance, end of year	<u>\$ 6,833,365</u>	<u>\$ 3,194,523</u>	<u>\$ 2,885,421</u>

At December 31, 2008 and 2007, the Company had \$12,162,153 and \$1,600,000, respectively, in nonaccrual loans and leases. Interest forgone on nonaccrual loans for the years ended December 31, 2008 and 2007 was \$633,908 and \$50,744, respectively. Interest forgone for the year ended December 31, 2006 was not material. The Company had no loans accruing interest that were over 90 days past due as of December 31, 2008 and 2007.

At December 31, 2008 and 2007, the recorded investment in impaired loans was \$14,638,289 and \$1,600,000, respectively. The Company had \$1,534,300 of specific allowance for loan losses on impaired loans of \$12,152,039 at December 31, 2008 as compared to \$227,000 of specific allowance for loan losses on impaired loans of \$1,600,000 at December 31, 2007. The average outstanding balance of impaired loans for the years ended December 31, 2008 and 2007 was \$6,686,982 and \$667,000, respectively, and no interest income was recognized on these loans.

Salaries and employee benefits totaling \$115,800, \$111,200 and \$133,100 were deferred as loan origination costs during the years ended December 31, 2008, 2007 and 2006, respectively.

NORCAL COMMUNITY BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

7. PREMISES AND EQUIPMENT

Premises and equipment consisted of the following:

	December 31,	
	2008	2007
Furniture and equipment	\$ 1,902,043	\$ 1,778,256
Leasehold improvements	1,128,245	1,120,245
	3,030,288	2,898,501
Less accumulated depreciation and amortization	(2,088,670)	(1,651,395)
	\$ 941,618	\$ 1,247,106

Depreciation and amortization included in occupancy and equipment expense totaled \$501,709, \$488,262, and \$289,567 for the years ended December 31, 2008, 2007 and 2006, respectively.

8. INTEREST-BEARING DEPOSITS

Interest-bearing deposits consisted of the following:

	December 31,	
	2008	2007
Savings	\$ 5,479,062	\$ 6,211,225
Money market	75,482,578	69,993,112
NOW accounts	35,081,733	34,959,735
Time, \$100,000 or more	24,091,277	25,350,838
Other time	30,610,288	20,999,023
	\$ 170,744,938	\$ 157,513,933

Aggregate annual maturities of time deposits are as follows:

Year Ending December 31,	
2009	\$ 51,357,579
2010	1,928,466
2011	732,519
2012	683,001
	\$ 54,701,565

NORCAL COMMUNITY BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

8. INTEREST-BEARING DEPOSITS (Continued)

Interest expense recognized on interest-bearing deposits consisted of the following:

	Year Ended December 31,		
	2008	2007	2006
Savings	\$ 13,782	\$ 28,196	\$ 40,144
Money market	2,029,143	2,555,433	2,278,909
NOW accounts	82,667	159,562	164,083
Time, \$100,000 or more	811,562	1,103,342	652,027
Other time	874,143	818,313	681,111
	\$ 3,811,297	\$ 4,664,846	\$ 3,816,274

9. BORROWING ARRANGEMENTS

The Company has \$8,500,000 in unsecured borrowing arrangements with three of its correspondent banks. There were no short-term borrowings outstanding under these arrangements at December 31, 2008 and 2007.

In addition, the Company can borrow up to the market value of securities pledged to another of its correspondent banks. At December 31, 2008, investment securities with amortized costs totaling \$1,000,000 and estimated fair values totaling \$1,026,000 were pledged to the correspondent bank under this agreement. At December 31, 2007, investment securities with amortized costs totaling \$500,000 and estimated fair values totaling \$501,000 were pledged to the correspondent bank under this agreement. At December 31, 2008 and 2007, the Company had no outstanding borrowings under this agreement.

Lastly, the Company can borrow from the Federal Home Loan Bank on either a short-term or long-term basis up to approximately \$62,922,000 and \$72,831,000 as of December 31, 2008 and 2007, respectively, based on specified percentages of the collateral pledged. Various loans totaling approximately \$148,541,000 as of December 31, 2008 and various loans and investment securities totaling approximately \$146,841,000 as of December 31, 2007, secure these borrowing arrangements. At December 31, 2008, short-term advances totaling \$11,000,000 bearing fixed rates of 0.05% to 3.07% and maturing in 2009 were outstanding under this agreement. At December 31, 2007, short-term advances totaling \$22,000,000 bearing fixed rates of 3.30% to 4.38% were outstanding under this agreement and matured in 2008.

NORCAL COMMUNITY BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

10. SUBORDINATED DEBENTURES

The following is a summary of the subordinated debentures due to the Company's grantor trusts at December 31, 2008:

Subordinated debentures due to NorCal Community Bancorp Trust I with interest payable quarterly, based on 3-month LIBOR plus 3.05%, repricing quarterly (7.87% at December 31, 2008), redeemable beginning October 7, 2008, and due October 7, 2033.	\$ 4,124,000
Subordinated debentures due to NorCal Community Bancorp Trust II with interest payable quarterly, based on 3-month LIBOR plus 1.40%, repricing quarterly (3.40% at December 31, 2008), redeemable beginning March 15, 2011, and due March 15, 2036.	<u>4,124,000</u>
	<u>\$ 8,248,000</u>

The Trusts have the option to defer payment of the distributions for a period of up to five years, as long as the Company is not in default on the payment of interest on the Subordinated Debentures. The Trust Preferred Securities were sold and issued in private transactions pursuant to an exemption from registration under the Securities Act of 1933, as amended.

Under applicable regulatory guidance, the amount of trust preferred securities that is eligible as Tier 1 capital is limited to 25% of the Company's Tier 1 capital on a pro forma basis. In 2012, amendments to the risk-based capital guidelines will become effective and the amount of trust preferred securities that may be included in Tier 1 capital may not exceed 25% of the sum of all core capital elements, including restricted core capital elements, net of goodwill less any associated deferred tax liability. At December 31, 2008, \$8,000,000 of the trust preferred securities qualified as Tier 1 capital.

The Company has guaranteed, on a subordinated basis, distributions and other payments due on trust preferred securities totaling \$8,000,000 issued by the grantor trusts which have identical maturity, repricing and payment terms as the subordinated debentures.

11. INCOME TAXES

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

	Federal	State	Total
<u>2008</u>			
Current	\$ (238,000)	\$ (105,000)	\$ (343,000)
Deferred	<u>(993,000)</u>	<u>(633,000)</u>	<u>(1,626,000)</u>
Provision for income taxes	<u>\$ (1,231,000)</u>	<u>\$ (738,000)</u>	<u>\$ (1,969,000)</u>

NORCAL COMMUNITY BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

11. INCOME TAXES (Continued)

	Federal	State	Total
<u>2007</u>			
Current	\$ 1,553,000	\$ 421,000	\$ 1,974,000
Deferred	(155,000)	(45,000)	(200,000)
Provision for income taxes	\$ 1,398,000	\$ 376,000	\$ 1,774,000
<u>2006</u>			
Current	\$ 1,828,000	\$ 550,000	\$ 2,378,000
Deferred	(150,000)	(37,000)	(187,000)
Provision for income taxes	\$ 1,678,000	\$ 513,000	\$ 2,191,000

Deferred tax assets (liabilities) consisted of the following:

	December 31,	
	2008	2007
Deferred tax assets:		
Allowance for loan and lease losses	\$ 2,649,000	\$ 1,286,000
Future benefit of State tax liability	1,000	124,000
Non-accrual interest	304,000	23,000
Other real estate owned	197,000	
Operating loss carryforwards	185,000	
Bank premises and equipment	175,000	181,000
Total deferred tax assets	3,511,000	1,614,000
Deferred tax liabilities:		
Future liability of State deferred tax assets	(325,000)	(105,000)
FHLB dividends	(62,000)	(51,000)
Deferred loan costs	(53,000)	(62,000)
Tax accounting for book accruals	(53,000)	(41,000)
Originated loan servicing	(54,000)	(17,000)
Unrealized gain on available-for-sale investment securities	(25,000)	(18,000)
Total deferred tax liabilities	(572,000)	(294,000)
Net deferred tax assets	\$ 2,939,000	\$ 1,320,000

The Company and its subsidiaries file income tax returns in the United States and California jurisdictions. With few exceptions, the Company is no longer subject to Federal examination for years ended before December 31, 2005 and State income tax examination by tax authorities for years ended before December 31, 2004.

NORCAL COMMUNITY BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

11. INCOME TAXES (Continued)

At December 31, 2008, the Company had State net operating loss carryforwards (NOLs) of \$1,710,000 which expire in 2028.

The provision for income taxes differs from amounts computed by applying the statutory Federal income tax rate to income before income taxes. The significant items comprising these differences for the years ended December 31, 2008, 2007 and 2006 are as follows:

	<u>2008</u>		<u>2007</u>		<u>2006</u>	
	<u>Amount</u>	<u>Rate %</u>	<u>Amount</u>	<u>Rate %</u>	<u>Amount</u>	<u>Rate %</u>
Federal income tax (benefit) expense, at statutory rate	\$(1,486,882)	(34.0)	\$ 1,580,175	34.0	\$ 1,881,666	34.0
State franchise tax (benefit), net of Federal tax effect	(417,595)	(9.5)	235,017	5.1	322,612	5.8
Interest on obligations of states and political subdivisions	(87,506)	(2.0)	(59,874)	(1.3)	(37,585)	(0.7)
Other	<u>22,983</u>	<u>0.5</u>	<u>18,682</u>	<u>0.4</u>	<u>24,307</u>	<u>0.4</u>
Total provision for income taxes	<u><u>\$(1,969,000)</u></u>	<u><u>(45.0)</u></u>	<u><u>\$ 1,774,000</u></u>	<u><u>38.2</u></u>	<u><u>\$ 2,191,000</u></u>	<u><u>39.5</u></u>

12. COMMITMENTS AND CONTINGENCIES

Operating Leases

The Company leases three branch offices, two commercial banking offices, a loan production office and an administrative office under non-cancelable operating leases. The leases were originated at various times beginning in 1998 and have remaining terms of between 15 and 63 months. The leases expire at different times through 2014, with some leases containing five year renewal options.

Future minimum lease payments are as follows:

<u>Year Ending</u> <u>December 31,</u>	
2009	\$ 720,932
2010	681,821
2011	675,470
2012	660,900
2013	474,986
2014	<u>24,060</u>
	<u><u>\$ 3,238,169</u></u>

NORCAL COMMUNITY BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

12. COMMITMENTS AND CONTINGENCIES (Continued)

Operating Leases (Continued)

Rental expense included in occupancy and equipment expense totaled \$852,178, \$905,103, and \$802,853 for the years ended December 31, 2008, 2007 and 2006, respectively.

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 standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized on the consolidated balance sheet.

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

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

	December 31,	
	2008	2007
Commitments to extend credit	\$ 45,222,000	\$ 64,832,000
Standby letters of credit	\$ 522,000	\$ 1,104,000

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. 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 being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness 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 of the borrower. Collateral held varies, but may include accounts receivable, inventory, and deeds of trust on residential real estate and income-producing commercial and agricultural properties.

Standby letters of credit are conditional commitments issued by the Bank 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.

NORCAL COMMUNITY BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

12. COMMITMENTS AND CONTINGENCIES (Continued)

Financial Instruments With Off-Balance-Sheet Risk (Continued)

The fair value of the liability related to these commitments to extend credit and 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.

At December 31, 2008, commercial loan commitments represent approximately 50% of total commitments and are generally secured by accounts receivable and inventory. Real estate loan commitments represent the remaining 50% of total commitments and are generally secured by property with a loan-to-value ratio not to exceed 75%. In addition, the majority of the Bank's loan commitments have variable interest rates.

Concentrations of Credit Risk

The Bank grants real estate mortgage, real estate construction, commercial, agricultural and consumer loans to customers in the Bank's geographic service area. Although the Bank has a diversified loan portfolio, a substantial portion of its portfolio is secured by real estate.

As of December 31, 2008, in management's judgment, a concentration existed in real estate loans. At that date, approximately 75% of the loans were real estate related, with commercial real estate loans representing 34%, real estate construction loans representing 31% and residential real estate loans representing 10% of total loans.

As of December 31, 2007, in management's judgment, a concentration existed in real estate loans. At that date, approximately 75% of the loans were real estate related, with commercial real estate loans representing 39%, real estate construction loans representing 27% and residential real estate loans representing 9% of total loans.

A substantial decline in the performance of the economy in general or a continued decline in real estate values in the Bank's primary market area, in particular, could have an adverse impact on collectibility, increase the level of real estate related nonperforming loans, or have other adverse effects which alone or in the aggregate could have a material adverse effect on the financial condition of the Bank. Management intends to reduce the concentration in nonowner-occupied commercial real estate and construction/land development loans.

Federal Reserve Requirement

Banks are required to maintain reserves with the Federal Reserve Bank equal to a percentage of their reservable deposits. The Bank's vault cash fulfilled its reserve requirement at December 31, 2008.

NORCAL COMMUNITY BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

12. COMMITMENTS AND CONTINGENCIES (Continued)

Correspondent Banking Agreements

The Company maintains funds on deposit with other federally insured financial institutions under correspondent banking agreements. Those insured financial institutions have elected to participate in the FDIC sponsored Transaction Account Guarantee Program. Under that program, through December 31, 2009, all noninterest-bearing transaction accounts are fully guaranteed by the FDIC for the entire amount in the account. Coverage under the Transaction Account Guarantee Program is in addition to and separate from the coverage available under the FDIC's general deposit insurance rules. This program was not in effect in 2007 and uninsured deposits totaled \$366,000 at December 31, 2007.

Contingencies

The Company is subject to legal proceedings and claims which arise in the ordinary course of business. In the opinion of management, the amount of ultimate liability with respect to such actions will not materially affect the consolidated financial position or consolidated results of operations of the Company.

13. SHAREHOLDERS' EQUITY

Dividend Restrictions

The Company's ability to pay cash dividends is dependent on dividends paid to it by the Bank and limited by California law. Under California law, the holders of common stock of the Company are entitled to receive dividends when and as declared by the Board of Directors, out of funds legally available, subject to certain restrictions. California General Corporation Law prohibits the Company from paying dividends on its common stock unless: (i) its retained earnings, immediately prior to the dividend payment, equals or exceeds the amount of the dividend or (ii) immediately after giving effect to the dividend, the sum of the Company's assets (exclusive of goodwill and deferred charges) would be at least equal to 125% of its liabilities (not including deferred taxes, deferred income and other deferred liabilities) and the current assets of the Company would be at least equal to its current liabilities, or, if the average of its earnings before taxes on income and before interest expense for the two preceding fiscal years was less than the average of its interest expense for the two preceding fiscal years, at least equal to 125% of its current liabilities. In addition, the Company's ability to pay dividends is subject to certain covenants contained in the indentures relating to the trust preferred securities issued by the grantor trusts (see Note 10).

Dividends from the Bank to the Company are restricted under certain federal laws and regulations governing banks. In addition, California law restricts the total dividend payments of any bank to the lesser of the bank's retained earnings or the bank's net income for the latest three fiscal years, less dividends previously paid during that period. As of December 31, 2008, the maximum amount available for dividend distributions by the Bank to the Company under these restrictions was approximately \$5,593,000.

NORCAL COMMUNITY BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

13. SHAREHOLDERS' EQUITY (Continued)

Earnings (Loss) Per Share

A reconciliation of the numerators and denominators of the basic and diluted earnings (loss) per share computations for the years ended December 31, 2008, 2007 and 2006 is shown below.

	<u>Net (Loss) Income</u>	<u>Weighted Average Number of Shares Outstanding</u>	<u>Per Share Amount</u>
<u>December 31, 2008</u>			
Basic loss per share	\$ (2,404,182)		
Beneficial interest from preferred stock conversion	<u>(263,728)</u>		
Net loss available to common shareholders	<u>(2,667,910)</u>	<u>3,037,949</u>	<u>\$ (0.88)</u>
Diluted loss per share	<u>\$ (2,667,910)</u>	<u>3,037,949</u>	<u>\$ (0.88)</u>
<u>December 31, 2007</u>			
Basic earnings per share	\$ 2,873,574	3,005,677	<u>\$ 0.96</u>
Effect of potentially dilutive shares		267,269	
Effect of convertible preferred stock		<u>33,237</u>	
Diluted earnings per share	<u>\$ 2,873,574</u>	<u>3,306,183</u>	<u>\$ 0.87</u>
<u>December 31, 2006</u>			
Basic earnings per share	\$ 3,343,311	2,770,620	<u>\$ 1.21</u>
Effect of potentially dilutive shares		<u>342,076</u>	
Diluted earnings per share	<u>\$ 3,343,311</u>	<u>3,112,696</u>	<u>\$ 1.07</u>

NORCAL COMMUNITY BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

13. SHAREHOLDERS' EQUITY (Continued)

Share-Based Compensation

Stock Options

Stock option activity for the years ended December 31, 2008, 2007 and 2006 is summarized as follows:

	2008		2007		2006	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Options outstanding, beginning of year	282,040	\$ 5.11	415,830	\$ 4.67	693,518	\$ 4.29
Options exercised	(107,392)	\$ 3.30	(118,077)	\$ 3.74	(273,563)	\$ 3.63
Options forfeited	<u>(14,391)</u>	\$ 3.35	<u>(15,713)</u>	\$ 4.21	<u>(4,125)</u>	\$ 10.37
Options outstanding, end of year	<u>160,257</u>	\$ 6.48	<u>282,040</u>	\$ 5.11	<u>415,830</u>	\$ 4.67
Options exercisable, end of year	<u>160,257</u>	\$ 6.48	<u>282,040</u>	\$ 5.11	<u>415,830</u>	\$ 4.67

The total intrinsic value of options exercised during the years ended December 31, 2008, 2007 and 2006 was \$1,241,597, \$1,755,076, and \$3,410,905, respectively. The aggregate intrinsic value of options outstanding, in-the-money and exercisable at December 31, 2008 was \$80,310.

A summary of options outstanding at December 31, 2008 follows:

<u>Range of Exercise Prices</u>	<u>Number of Options Outstanding December 31, 2008</u>	<u>Weighted Average Remaining Contractual Life</u>	<u>Options Exercisable December 31, 2008</u>
\$ 4.45	47,250	3.7 years	47,250
\$ 5.11	3,375	2.1 years	3,375
\$ 5.37	10,125	1.4 years	10,125
\$ 5.63	57,882	1.5 years	57,882
\$ 8.22	21,375	4.8 years	21,375
\$ 12.00	1,500	5.9 years	1,500
\$ 12.67	<u>18,750</u>	5.5 years	<u>18,750</u>
	<u>160,257</u>		<u>160,257</u>

NORCAL COMMUNITY BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

13. SHAREHOLDERS' EQUITY (Continued)

Share-Based Compensation (Continued)

Restricted Common Stock Awards

Restricted common stock activity for the years ended December 31, 2008, 2007 and 2006 is summarized as follows:

	<u>2008</u>		<u>2007</u>		<u>2006</u>	
	Shares	Weighted Average Grant- Date Fair Value	Shares	Weighted Average Grant- Date Fair Value	Shares	Weighted Average Grant- Date Fair Value
Unvested shares outstanding, beginning of year	60,685	\$ 18.08	67,237	\$ 18.57		
Shares awarded			9,910	\$ 15.55	67,237	\$ 18.57
Shares vested	(19,054)	\$ 18.01	(14,249)	\$ 18.57		
Shares forfeited			(2,213)	\$ 18.57		
Unvested shares outstanding, end of year	<u>41,631</u>	\$ 18.11	<u>60,685</u>	\$ 18.08	<u>67,237</u>	\$ 18.57

A summary of restricted common stock outstanding at December 31, 2008 follows:

<u>Range of Grant-Date Fair Values</u>	<u>Number of Unvested Shares December 31, 2008</u>	<u>Weighted Average Remaining Vesting Period</u>
\$ 18.57	2,988	8 months
\$ 18.57	32,287	2.8 years
\$ 15.55	<u>6,356</u>	1.7 years
	<u>41,631</u>	

The restricted common stock awards vest in equal installments over either a three or a five year period on the anniversary dates of the awards as established by the Board of Directors. Participants receiving these restricted common stock awards were granted the right to dividend payments as well as voting rights on the non-vested shares.

The compensation cost that has been charged against income for restricted common stock awards was approximately \$341,000 and \$321,000 for the years ended December 31, 2008 and 2007, respectively.

NORCAL COMMUNITY BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

13. SHAREHOLDERS' EQUITY (Continued)

Share-Based Compensation (Continued)

Restricted Common Stock Awards (Continued)

At December 31, 2008, the total compensation cost related to non-vested restricted common stock not yet recognized was approximately \$699,000. At December 31, 2007, the total compensation cost related to non-vested restricted common stock not yet recognized was approximately \$1,040,000. Restricted common stock compensation expense is recognized on a straight-line basis over the vesting period. The intrinsic value of unvested restricted common stock outstanding was approximately \$241,000 and \$928,000 as of December 31, 2008 and 2007, respectively.

Stock Split

On November 16, 2006, the Board of Directors declared a three-for-two stock split payable on December 7, 2006 to shareholders of record on November 22, 2006. All per share, shares outstanding and stock option data in the consolidated financial statements have been retroactively restated to reflect the stock split.

Preferred Stock

In May 2007, the Company completed a private offering of series A Convertible Preferred Stock. The Company authorized 10,000,000 shares of preferred stock and 65,932 shares were issued at \$16 per share for total proceeds of \$1,054,912. The preferred stock was recorded net of \$45,958 in stock offering costs. The holders of the Series A preferred stock were not entitled to cash dividends and had no voting rights.

In the event of any liquidation, dissolution or winding up of the Company, the holders of the Series A Preferred Stock were entitled to receive, in preference to holders of common stock, an amount equal to the Series A Preferred Stock Per Share Purchase Price. Thereafter, any remaining assets would have been distributed solely to the holders of common stock.

On September 30, 2008, the preferred stock automatically converted into a number of fully paid and nonassessable shares of common stock based on achieving the following customer deposit goal at the Oakland branch for the three month period ended September 30, 2008:

Oakland Office Customer Deposit Goal	Conversion Rate for One Share of Series A Preferred Stock
\$20,000,000 up to \$26,000,000	1.25 shares of common stock

A beneficial conversion factor of \$263,728, representing 16,483 additional shares at the original conversion price of \$16, was recorded as a reduction of retained earnings and an increase in preferred stock prior to conversion. All preferred stock was then converted to common stock on September 30, 2008.

NORCAL COMMUNITY BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

13. SHAREHOLDERS' EQUITY (Continued)

Common Stock Repurchase Program

Effective January 2008, the Board of Directors of the Company authorized a stock repurchase program. Repurchases are limited to the lesser of 120,000 shares, four percent of outstanding common stock or the number of shares with an aggregate repurchase price of \$2,000,000. The repurchases are to be made from time to time as conditions allow. The Board of Directors has reserved the right to suspend, terminate, modify or cancel this repurchase program at any time for any reason. During 2008, 35,000 shares were repurchased for \$554,500 under this plan.

Regulatory Matters

As a result of a regulatory examination completed subsequent to December 31, 2008, the Bank must maintain a minimum leverage ratio of 10 percent. In addition, the Bank must obtain approval to pay cash dividends from the FDIC and DFI.

Regulatory Capital

The Company and the Bank are subject to certain regulatory capital requirements administered by the Board of Governors of the Federal Reserve System and 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 Company's consolidated financial statements.

Under capital adequacy guidelines, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. These quantitative measures are established by regulation and require that minimum amounts and ratios of total and Tier 1 capital to risk-weighted assets and of Tier 1 capital to average assets be maintained. Capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

The Bank is also subject to additional capital guidelines 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 in the table on the following page. The most recent notification from the FDIC categorized the Bank as well capitalized under these guidelines.

Management believes that the Company and the Bank met all their capital adequacy requirements as of December 31, 2008 and 2007.

NORCAL COMMUNITY BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

13. SHAREHOLDERS' EQUITY (Continued)

Regulatory Capital (Continued)

	December 31,			
	2008		2007	
	Amount	Ratio	Amount	Ratio
<u>Leverage Ratio</u>				
NorCal Community Bancorp and Subsidiary	\$ 32,038,000	11.6%	\$ 34,673,000	12.6%
Minimum regulatory requirement	\$ 11,062,000	4.0%	\$ 11,000,000	4.0%
Bank of Alameda	\$ 29,895,000	10.8%	\$ 29,661,000	10.8%
Minimum requirement for "Well-Capitalized" institution under prompt corrective action provisions	\$ 13,791,000	5.0%	\$ 13,703,000	5.0%
Minimum regulatory requirement	\$ 11,033,000	4.0%	\$ 10,963,000	4.0%
<u>Tier 1 Risk-Based Capital Ratio</u>				
NorCal Community Bancorp and Subsidiary	\$ 32,038,000	13.2%	\$ 34,673,000	13.4%
Minimum regulatory requirement	\$ 9,711,000	4.0%	\$ 10,387,000	4.0%
Bank of Alameda	\$ 29,895,000	12.4%	\$ 29,661,000	11.5%
Minimum requirement for "Well-Capitalized" institution under prompt corrective action provisions	\$ 14,517,000	6.0%	\$ 15,517,000	6.0%
Minimum regulatory requirement	\$ 9,678,000	4.0%	\$ 10,345,000	4.0%
<u>Total Risk-Based Capital Ratio</u>				
NorCal Community Bancorp and Subsidiary	\$ 35,120,000	14.5%	\$ 37,919,000	14.6%
Minimum regulatory requirement	\$ 19,421,000	8.0%	\$ 20,773,000	8.0%
Bank of Alameda	\$ 32,967,000	13.6%	\$ 32,894,000	12.7%
Minimum requirement for "Well-Capitalized" institution under prompt corrective action provisions	\$ 24,194,000	10.0%	\$ 25,862,000	10.0%
Minimum regulatory requirement	\$ 19,355,000	8.0%	\$ 20,690,000	8.0%

14. LOANS TO RELATED PARTIES

During the normal course of business, the Company enters into transactions with related parties, including Directors and officers. These transactions include borrowings from the Company 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:

Balance, January 1, 2008	\$ 130,000
Amounts repaid	(130,000)
Balance, December 31, 2008	\$ -
Undisbursed commitments to related parties, December 31, 2008	\$ -

NORCAL COMMUNITY BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

15. OTHER EXPENSES

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

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Data processing	\$ 701,053	\$ 718,022	\$ 644,691
Other real estate impairment	439,397		
Professional fees	379,380	373,798	350,101
Director fees	216,155	231,650	221,999
Advertising and promotion	164,775	223,779	182,252
Insurance	151,375	135,831	151,853
Regulatory fees	195,526	131,868	65,184
Other operating expenses	<u>1,088,332</u>	<u>928,983</u>	<u>654,817</u>
	<u>\$ 3,335,993</u>	<u>\$ 2,743,931</u>	<u>\$ 2,270,897</u>

16. COMPREHENSIVE INCOME (LOSS)

Comprehensive income (loss) is reported in addition to net income (loss) for all periods presented. Comprehensive income (loss) is a more inclusive financial reporting methodology that includes disclosure of other comprehensive income (loss) that historically has not been recognized in the calculation of net income. Unrealized holding gains and losses on the Company's available-for-sale investment securities are included in other comprehensive income (loss). Total comprehensive income (loss) and the components of accumulated other comprehensive income (loss) are presented in the statement of changes in shareholders' equity.

For the years ended December 31, 2008, 2007 and 2006, the Company held securities classified as available-for-sale which had unrealized holding gains (losses) as follows:

	<u>Before Tax</u>	<u>Tax (Expense) Benefit</u>	<u>After Tax</u>
<u>For the Year Ended December 31, 2008</u>			
Other comprehensive income:			
Unrealized holding gains	<u>\$ 16,430</u>	<u>\$ (6,736)</u>	<u>\$ 9,694</u>
<u>For the Year Ended December 31, 2007</u>			
Other comprehensive income:			
Unrealized holding gains	<u>\$ 123,866</u>	<u>\$ (50,677)</u>	<u>\$ 73,189</u>
<u>For the Year Ended December 31, 2006</u>			
Other comprehensive income:			
Unrealized holding gains	<u>\$ 140,636</u>	<u>\$ (57,708)</u>	<u>\$ 82,928</u>

NORCAL COMMUNITY BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

17. EMPLOYEE RETIREMENT PLAN

During 1998, the Board of Directors adopted a Salary Deferral 401(k) Plan. The plan is available to employees meeting certain age and length of service requirements. Under the plan, employees can defer a selected portion of their annual compensation and the Company may match each employee contribution in an amount to be determined annually under a formula established by the Company. The Company made contributions of \$140,530, \$130,081, and \$110,960 for the years ended December 31, 2008, 2007 and 2006, respectively.

NORCAL COMMUNITY BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

18. PARENT ONLY CONDENSED FINANCIAL STATEMENTS

CONDENSED BALANCE SHEET

December 31, 2008 and 2007

	<u>2008</u>	<u>2007</u>
ASSETS		
Cash and due from banks	\$ 1,660,447	\$ 4,323,254
Investment in Bank subsidiary	29,947,275	29,731,347
Intercompany receivable - eliminated in consolidation	495,482	712,411
Accrued interest receivable and other assets	<u>318,601</u>	<u>316,941</u>
Total assets	<u>\$32,421,805</u>	<u>\$35,083,953</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Accrued interest payable and other liabilities	\$ 84,022	\$ 92,856
Subordinated debentures	<u>8,248,000</u>	<u>8,248,000</u>
Total liabilities	<u>8,332,022</u>	<u>8,340,856</u>
Shareholders' equity:		
Preferred stock, net of stock issuance costs		1,008,954
Common stock	11,552,889	10,539,033
Retained earnings	12,501,624	15,169,534
Accumulated other comprehensive income, net of taxes	<u>35,270</u>	<u>25,576</u>
Total shareholders' equity	<u>24,089,783</u>	<u>26,743,097</u>
Total liabilities and shareholders' equity	<u>\$32,421,805</u>	<u>\$35,083,953</u>

NORCAL COMMUNITY BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

18. PARENT ONLY CONDENSED FINANCIAL STATEMENTS (Continued)

CONDENSED STATEMENT OF INCOME

For the Years Ended December 31, 2008, 2007 and 2006

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Income:			
Earnings from investments in statutory trusts	\$ <u>14,658</u>	\$ <u>19,112</u>	\$ <u>18,368</u>
Total income	<u>14,658</u>	<u>19,112</u>	<u>18,368</u>
Expenses:			
Interest expense	474,289	638,095	608,393
Salaries and benefits	448,384	423,951	90,929
Other expenses	<u>129,306</u>	<u>126,817</u>	<u>137,181</u>
Total expenses	<u>1,051,979</u>	<u>1,188,863</u>	<u>836,503</u>
Loss before equity in undistributed income of Bank subsidiary	(1,037,321)	(1,169,751)	(818,135)
Equity in undistributed (loss) income of Bank subsidiary	<u>(1,793,764)</u>	<u>3,561,920</u>	<u>3,824,747</u>
(Loss) income before provision for income tax benefit	(2,831,085)	2,392,169	3,006,612
Provision for income tax benefit	<u>426,903</u>	<u>481,405</u>	<u>336,699</u>
Net (loss) income	<u>\$ (2,404,182)</u>	<u>\$ 2,873,574</u>	<u>\$ 3,343,311</u>

NORCAL COMMUNITY BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

18. PARENT ONLY CONDENSED FINANCIAL STATEMENTS (Continued)

CONDENSED STATEMENT OF CASH FLOWS

For the Years Ended December 31, 2008, 2007 and 2006

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Cash flows from operating activities:			
Net (loss) income	\$ (2,404,182)	\$ 2,873,574	\$ 3,343,311
Adjustments to reconcile net loss (income) to net cash (used in) provided by operating activities:			
Undistributed net loss (income) of Bank subsidiary	1,793,764	(3,561,920)	(3,824,747)
Restricted common stock compensation expense	341,061	321,412	
Tax benefit from exercise of stock options	(67,579)	(287,359)	(1,267,603)
Decrease (increase) in intercompany receivable	284,510	1,172,552	(141,185)
(Increase) decrease in other assets	(1,660)	(3,415)	4,631
(Decrease) increase in accrued interest payable and other liabilities	<u>(8,834)</u>	<u>(57,240)</u>	<u>9,939</u>
Net cash (used in) provided by operating activities	<u>(62,920)</u>	<u>457,604</u>	<u>(1,875,654)</u>
Cash flows from investing activities:			
Capital contributed to Bank subsidiary	(2,000,000)		(2,000,000)
Investment in subsidiary grantor trust			<u>(124,000)</u>
Net cash used in investing activities	<u>(2,000,000)</u>		<u>(2,124,000)</u>
Cash flows from financing activities:			
Proceeds from issuance of preferred stock, net of stock issuance costs		1,008,954	
Proceeds from issuance of subordinated debentures to subsidiary grantor trust			4,124,000
Cash paid for fractional shares		(303)	(2,887)
Repurchase of common stock	(875,068)	(84,955)	(93,275)
Proceeds from exercise of stock options	207,602	229,510	992,815
Tax benefit from exercise of stock options	<u>67,579</u>	<u>287,359</u>	<u>1,267,603</u>
Net cash (used in) provided by financing activities	<u>(599,887)</u>	<u>1,440,565</u>	<u>6,288,256</u>
(Decrease) increase in cash and cash equivalents	(2,662,807)	1,898,169	2,288,602
Cash and cash equivalents at beginning of year	<u>4,323,254</u>	<u>2,425,085</u>	<u>136,483</u>
Cash and cash equivalents at end of year	<u>\$ 1,660,447</u>	<u>\$ 4,323,254</u>	<u>\$ 2,425,085</u>