

FEDERAL DEPOSIT INSURANCE CORPORATION

WASHINGTON, D.C. 20429

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2011

FDIC Certificate No.32203

Summit State Bank

(exact name of registrant as specified in its charter)

94-2878925

(I.R.S Employer Identification No.)

California

(State or other jurisdiction of incorporation or organization)

500 Bicentennial Way, Santa Rosa, CA 95403 Telephone: 707-568-6000

(Address of principal executive offices) (Zip Code) (Registrant's telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of "accelerated filer, large accelerated filer and smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller Reporting Company

Indicate by check mark whether the registrant is a shell company, in Rule 12b(2) of the Exchange Act. Yes

No

As of May 10, 2011 there were 4,744,720 shares of common stock outstanding.

Summit State Bank

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Part I Financial Information

SUMMIT STATE BANK AND SUBSIDIARY CONSOLIDATED BALANCE SHEETS

(In thousands except share and per share data)

	<u>March 31,</u> <u>2011</u> <small>(unaudited)</small>	<u>December 31,</u> <u>2010</u>
ASSETS		
Cash and due from banks	\$ 9,486	\$ 4,542
Federal funds sold	-	7,940
Total cash and cash equivalents	<u>9,486</u>	<u>12,482</u>
Available-for-sale investment securities - amortized cost of \$60,841 in 2011 and \$33,472 in 2010	61,084	33,642
Loans, less allowance for loan losses of \$6,723 in 2011 and \$6,058 in 2010	280,284	280,398
Bank premises and equipment, net	7,185	7,304
Investment in Federal Home Loan Bank stock, at cost	2,510	2,614
Goodwill	4,119	4,119
Accrued interest receivable and other assets	<u>9,450</u>	<u>7,374</u>
Total assets	<u>\$ 374,118</u>	<u>\$ 347,933</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Demand - non interest-bearing	\$ 31,077	\$ 23,594
Demand - interest-bearing	24,122	24,421
Savings	20,344	15,849
Money market	38,447	38,063
Time deposits, \$100,000 and over	129,898	113,187
Other time deposits	<u>56,220</u>	<u>64,863</u>
Total deposits	300,108	279,977
Federal Home Loan Bank (FHLB) advances	17,100	12,000
Accrued interest payable and other liabilities	<u>1,605</u>	<u>647</u>
Total liabilities	<u>318,813</u>	<u>292,624</u>
Shareholders' equity		
Preferred stock, no par value; 20,000,000 shares authorized; shares issued and outstanding - 8,500 in 2011 and 2010; per share redemption of \$1,000 for total liquidation preference of \$8,500	8,149	8,117
Common stock, no par value; shares authorized - 30,000,000 shares; issued and outstanding 4,744,720 at March 31, 2011 and December 31, 2010	36,322	36,311
Common stock warrant	622	622
Retained earnings	10,072	10,161
Accumulated other comprehensive income, net of taxes of \$103 and \$72	<u>140</u>	<u>98</u>
Total shareholders' equity	<u>55,305</u>	<u>55,309</u>
Total liabilities and shareholders' equity	<u>\$ 374,118</u>	<u>\$ 347,933</u>

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

SUMMIT STATE BANK AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME

(In thousands except per share data)

(In thousands except for earnings per share data)	Three Months Ended	
	March 31, 2011 (unaudited)	March 31, 2010 (unaudited)
Interest income:		
Interest and fees on loans	\$ 4,245	\$ 4,473
Interest on federal funds sold	5	2
Interest on investment securities and deposits in banks	436	359
Dividends on FHLB stock	2	2
Total interest income	4,688	4,836
Interest expense:		
Deposits	658	820
FHLB advances	87	136
Total interest expense	745	956
Net interest income before provision for loan losses	3,943	3,880
Provision for loan losses	800	1,010
Net interest income after provision for loan losses	3,143	2,870
Non-interest income:		
Service charges on deposit accounts	117	93
Office leases	138	126
Net securities gains	-	150
Loan servicing, net	7	12
Other income	-	46
Total non-interest income	262	427
Non-interest expense:		
Salaries and employee benefits	1,322	1,242
Occupancy and equipment	390	389
Other expenses	880	748
Total non-interest expense	2,592	2,379
Income before provision for income taxes	813	918
Provision for income taxes	336	378
Net income	\$ 477	\$ 540
Less: preferred dividends	138	138
Net income available for common stockholders	\$ 339	\$ 402
Basic earnings per common share	\$ 0.07	\$ 0.08
Diluted earnings per common share	\$ 0.07	\$ 0.08
Basic weighted average shares of common stock outstanding	4,745	4,745
Diluted weighted average shares of common stock outstanding	4,794	4,762

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

SUMMIT STATE BANK AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

For the Three Months Ended March 31, 2011 (Unaudited) and the Year Ended December 31, 2010
(In thousands, except share and dividends per share)

	Preferred Stock and Common Stock Warrant Amount	Common Stock		Retained Earnings	Accumulated Other Comprehensive Income (Loss) (Net of Taxes)	Total Shareholders' Equity	Total Compre- hensive Income
		Shares	Amount				
Balance, January 1, 2010	\$ 8,611	\$ 4,745	\$ 36,275	\$ 10,615	\$ 4	\$ 55,505	
Comprehensive income:							
Net income				1,807		1,807	\$ 1,807
Other comprehensive income net of tax:							
Net change in unrealized gains (losses) on available-for-sale investment securities					94	94	94
Total comprehensive income							<u>\$ 1,901</u>
Stock-based compensation expense			36			36	
Preferred stock dividends				(424)		(424)	
Accretion of preferred stock discount	128			(128)		-	
Cash dividends - \$.36 per share				(1,709)		(1,709)	
Balance, December 31, 2010	8,739	4,745	36,311	10,161	98	55,309	
Comprehensive income:							
Net income				477		477	\$ 477
Other comprehensive income, net of tax:							
Net change in unrealized gains (losses) on available-for-sale investment securities					42	42	42
Total comprehensive income							<u>\$ 519</u>
Stock-based compensation expense			11			11	
Preferred stock dividend				(106)		(106)	
Accretion of preferred stock discount	32			(32)		-	
Cash dividends - \$.09 per share				(428)		(428)	
Balance, March 31, 2011	<u>\$ 8,771</u>	<u>\$ 4,745</u>	<u>\$ 36,322</u>	<u>\$ 10,072</u>	<u>\$ 140</u>	<u>\$ 55,305</u>	

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

SUMMIT STATE BANK AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three Months Ended March 31,	
(In thousands)	2011	2010
	(Unaudited)	(Unaudited)
Cash flows from operating activities:		
Net income	\$ 477	\$ 540
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	192	195
Loss on disposal of bank premises and equipment	-	33
Net increase(decrease) in deferred loan fees	(87)	(217)
Provision for loan losses	800	1,010
Net securities gains	-	(150)
Net change in accrued interest receivable and other assets	(1,669)	456
Net change in accrued interest payable and other liabilities	958	73
Stock-based compensation expense	11	6
Net cash from operating activities	682	1,946
Cash flows from investing activities:		
Purchases of available-for-sale investment securities	(27,910)	(5,547)
Proceeds from sales of available-for-sale investment securities	-	2,350
Proceeds from calls and maturities of available-for-sale investment securities	541	2,098
Proceeds from the redemption of Federal Home Loan Bank stock	104	-
Net change in loans	(1,037)	2,523
Purchases of bank premises and equipment, net	(73)	(81)
Proceeds on sale of other real estate owned	-	-
Net cash from investing activities	(28,375)	1,343

(Continued)

**SUMMIT STATE BANK AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS**

	Three Months Ended March 31,	
(In thousands)	2011	2010
	(Unaudited)	(Unaudited)
Cash flows from financing activities:		
Net increase (decrease) in demand, NOW, savings and money market deposits	12,063	(1,854)
Net change in certificates of deposit	8,068	12,495
Net change in short term FHLB advances	5,100	(1,120)
Dividends paid on common stock	(428)	(427)
Dividends paid on preferred stock	(106)	(106)
Net cash from financing activities	24,697	8,988
Net change in cash and cash equivalents	(2,996)	12,277
Cash and cash equivalents at beginning of year	12,482	2,933
Cash and cash equivalents at end of period	\$ 9,486	\$ 15,210
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Interest	\$ 745	\$ 946
Income taxes	\$ -	\$ -
Noncash investing activities:		
Transfer from loans to other real estate owned	\$ 438	\$ 71

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

SUMMIT STATE BANK AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General

On January 15, 1999, Summit State Bank (the “Bank” or “the Bank”) received authority to transact business as a California state-chartered commercial bank and is subject to regulation, supervision and examination by the California Department of Financial Institutions and the Federal Deposit Insurance Corporation. The Bank was incorporated on December 20, 1982 under the name Summit Savings. The Bank provides a variety of banking services to individuals and businesses in its primary service area of Sonoma County, California. The Bank's branch locations include Santa Rosa, Petaluma, Rohnert Park and Healdsburg. The Bank offers depository and lending services primarily to meet the needs of its business and individual clientele. These services include a variety of transaction, money market, savings and time deposit account alternatives. The Bank's lending activities are directed primarily towards commercial real estate, construction and business loans. The Bank utilizes its subsidiary Alto Service Corporation for its deed of trust services.

The consolidated financial statements as of March 31, 2011 and for the three months ended March 31, 2011 and 2010 are unaudited. In the opinion of management, these unaudited consolidated financial statements contain all adjustments, consisting only of normal recurring accruals necessary to present fairly the consolidated financial statements of the Bank.

The accompanying unaudited consolidated interim financial statements have been prepared in accordance with U.S. Generally Accepted Accounting Principles for interim financial information and Article 8 of Regulation S-X of the Securities and Exchange Commission. Operating results for the three months ended March 31, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011. These unaudited consolidated financial statements do not include all disclosures associated with the Bank's consolidated annual financial statements and notes thereto and accordingly, should be read in conjunction with the consolidated financial statements and notes thereto included in the Bank's Annual Report for the year ended December 31, 2010 on Form 10-K on file with the FDIC (Form 10-K may be found at www.summitstatebank.com).

The accompanying accounting and reporting policies of the Bank and subsidiary conform to U.S. Generally Accepted Accounting Principles and prevailing practices within the banking industry.

Principles of Consolidation

The consolidated financial statements include the accounts of the Bank and its wholly-owned subsidiary, Alto Service Corporation. All significant intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with U.S. Generally Accepted Accounting Principles requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates. The allowance for loan losses, goodwill impairment and fair values of investment securities and other financial instruments are particularly subject to change.

Earnings Per Common Share

Basic earnings per common share (EPS), which excludes dilution, is computed by dividing income available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted earnings per common share reflects the potential dilution that could occur if securities or other contracts to issue common stock, such as stock options and the warrant, result in the issuance of common stock which share in the earnings of the Bank. Stock Options for 123,166 and 128,166 shares of common stock for the three months ended March 31, 2011 and 2010 were not considered in computing diluted earnings per share because they were anti-dilutive. The warrant for 239,212 shares of common stock was not considered in computing diluted earnings per share for the three months ended March 31, 2011 and 2010 because it was anti-dilutive.

The factors used in the earnings per common share computation follow:

(in thousands except earnings per share)	<u>Three Months Ended</u>	
	<u>March 31, 2011</u>	<u>March 31, 2010</u>
Basic		
Net income available for common shareholders	<u>\$ 339</u>	<u>\$ 402</u>
Weighted average common shares outstanding	<u>4,745</u>	<u>4,745</u>
Basic earnings per common share	<u>\$ 0.07</u>	<u>\$ 0.08</u>
Diluted		
Net income available for common shareholders	<u>\$ 339</u>	<u>\$ 402</u>
Weighted average common shares outstanding for basic earnings per common share	4,745	4,745
Add: Dilutive effects of assumed exercises of stock options and warrant	<u>50</u>	<u>17</u>
Average shares and dilutive potential common shares	<u>4,794</u>	<u>4,762</u>
Diluted earnings per common share	<u>\$ 0.07</u>	<u>\$ 0.08</u>

2. COMPREHENSIVE INCOME

Comprehensive income consists of net income and other comprehensive income (loss) (“OCI”). Other comprehensive income includes unrealized gains and losses on securities available-for-sale. All items reported in other comprehensive income are reported net of tax. Following is a summary of other comprehensive income for the three months ended March 31, 2011 and 2010:

(In Thousands)	<u>Three Month's Ended March 31,</u>	
	<u>2011</u>	<u>2010</u>
Net income	477	\$ 540
Change in securities available-for-sale:		
Unrealized holding gains (losses) on available-for-sale securities arising during the period	73	393
Other-than-temporary impairment on available for sale securities associated with credit losses realized in income	-	-
Reclassification adjustment for (gains) losses realized in income on available-for-sale securities	<u>-</u>	<u>(150)</u>
Net unrealized gains	73	243
Income tax expense	<u>31</u>	<u>102</u>
Total other comprehensive income	<u>42</u>	<u>141</u>
Comprehensive income	<u>\$ 519</u>	<u>\$ 681</u>

3. REGULATORY CAPITAL

The Bank's actual and required capital amounts and ratios consisted of the following:

(in thousands)	March 31, 2011	
	Amount	Ratio
<u>Tier 1 Leverage Ratio</u>		
Summit State Bank	\$ 51,007	14.5%
Minimum requirement for "Well-Capitalized" institution	\$ 17,651	5.0%
Minimum regulatory requirement	\$ 14,120	4.0%
<u>Tier 1 Risk-Based Capital Ratio</u>		
Summit State Bank	\$ 51,007	17.3%
Minimum requirement for "Well-Capitalized" institution	\$ 17,635	6.0%
Minimum regulatory requirement	\$ 11,757	4.0%
<u>Total Risk-Based Capital Ratio</u>		
Summit State Bank	\$ 54,719	18.6%
Minimum requirement for "Well-Capitalized" institution	\$ 29,392	10.0%
Minimum regulatory requirement	\$ 23,514	8.0%

4. STOCK OPTIONS

The shareholders approved the 2007 stock option plan ("Plan") on May 21, 2007. The Plan reserved 150,000 shares of common stock for issuance to Bank employees. The Plan requires that the option exercise price may not be less than the fair market value of the stock at the date the option is granted. Option awards have vesting periods of 5 years unless otherwise approved by the Board of Directors. The option expiration dates are determined by the Board of Directors, but may not be later than ten years from the date of grant. No options were granted during the three months ended March 31, 2011. During the three months ended March 21, 2010, 20,000 shares were granted at an exercise price of \$6.28. As of March 31, 2011, 42,500 shares remain available for future grants under the Plan. There were 138,166 options outstanding as of March 31, 2011, which includes options granted under the Plan and under prior stock option plans.

5. COMMITMENTS AND CONTINGENCIES

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

The Bank's business activity is primarily with clients located within Northern California. Although the Bank has a diversified loan portfolio, a significant portion of its clients' ability to repay loans is dependent upon the real estate market and various economic factors within Sonoma County. Generally, loans are secured by various forms of collateral. The Bank's loan policy requires sufficient collateral to be obtained as necessary to meet the Bank's relative risk criteria for each borrower. The Bank's collateral for the lending portfolio consists primarily of real estate, accounts receivable, inventory and other financial instruments.

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 clients 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 sheets. 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.

Commitments to extend credit, which totaled \$14,683,000 and \$12,483,000 at March 31, 2011 and December 31, 2010, are agreements to lend to a client 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 client's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of the credit, is based on management's credit evaluation of the borrower. Collateral held relating to these commitments varies, but may include securities, equipment, accounts receivable, inventory and deeds of trust on residential real estate and income-producing commercial properties.

Standby letters of credit, which totaled \$209,000 at March 31, 2011 and December 31, 2010 are conditional commitments issued by the Bank to guarantee the performance of a client to a first party. The credit risk involved in issuing standby letters of credit is essentially the same as that involved in extending loans to clients. The fair value of the liability related to these standby letters of credit, which represents the fees received for issuing the guarantees, was not significant at March 31, 2011 and December 31, 2010. The Bank recognizes these fees as revenue over the term of the commitment or when the commitment is used.

6. FAIR VALUE

Accounting standards establish a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standards describe three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The fair values of most securities available-for-sale are determined by matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities, but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs).

The fair value of impaired loans with specific allocations of the allowance for loan losses based on collateral values is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are typically significant and typically result in a level 3 classification of the inputs for determining fair value.

Assets Measured on a Recurring Basis

	Fair Value Measurements at March 31, 2011			
	(In thousands)			
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:	March 31, 2011			
Government agencies	\$ 43,464	\$ -	\$ 43,464	\$ -
Mortgage-backed securities - residential	4,289	-	4,289	-
Corporate securities	13,331	13,331	-	-
Total securities available -for-sale	<u>\$ 61,084</u>	<u>\$ 13,331</u>	<u>\$ 47,753</u>	<u>\$ -</u>

	Fair Value Measurements at December 31, 2010			
	(In thousands)			
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:	December 31, 2010			
Government agencies	\$ 29,308	\$ -	\$ 29,308	\$ -
Mortgage-backed securities - residential	4,334	-	4,334	-
Total securities available -for-sale	<u>\$ 33,642</u>	<u>\$ -</u>	<u>\$ 33,642</u>	<u>\$ -</u>

Assets Measured on a Non-Recurring Basis

	Fair Value Measurements at March 31, 2011			
	(In thousands)			
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:	March 31, 2011			
Commercial & agricultural	\$ 1,232	\$ -	\$ -	\$ 1,232
Real estate - commercial	9,254	-	-	9,254
Real estate - construction	1,422	-	-	1,422
Real estate - single family units	732	-	-	732
Real estate - multifamily	3,135	-	-	3,135
Real estate - land loans	-	-	-	-
Consumer	-	-	-	-
Lease financing	-	-	-	-
Total impaired loans	\$ 15,775	\$ -	\$ -	\$ 15,775
Mortgage servicing rights	-	-	-	-
Other real estate owned	468	-	-	468
Total assets	<u>\$ 16,243</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 16,243</u>

	Fair Value Measurements at December 31, 2010			
	(In thousands)			
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:	December 31, 2010			
Commercial & agricultural	\$ 3,452	\$ -	\$ -	\$ 3,452
Real estate - commercial	2,003	-	-	2,003
Real estate - construction	1,870	-	-	1,870
Real estate - single family units	954	-	-	954
Real estate - multifamily	-	-	-	-
Real estate - land loans	3,671	-	-	3,671
Consumer	-	-	-	-
Lease financing	-	-	-	-
Impaired loans with specific loss allocations	\$ 11,950	\$ -	\$ -	\$ 11,950

The following impairment charges recognized during the three months ended March 31, 2011 and 2010 for assets measured at fair value on a non-recurring basis are discussed below.

Impaired loans with specific loss allocations had a principal balance of \$18,928,000 with a valuation allowance of \$3,153,000 at March 31, 2011. Impaired loans with specific loss allocations had a principal balance of \$13,990,000 with a valuation allowance of \$2,040,000 at December 31, 2010. An additional provision for loan losses of \$1,166,000 and \$1,830,000 was recognized for impaired loans with specific loss allocations for the three months ended March 31, 2011 and the year ended December 31, 2010 respectively.

Other real estate owned at March 31, 2011, represents two foreclosed properties with a principal balance of \$468,000 and a valuation allowance of \$0. One property for \$147,000 is a single family residence and the other property for \$321,000 is a commercial property.

7. DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS

Estimated fair values are disclosed for financial instruments for which it is practicable to estimate fair value. These estimates are made at a specific point in time based on relevant market data and information about the financial instruments. These estimates do not reflect any premium or discount that could result from offering the Bank's entire holdings of a particular financial instrument for sale at one time, nor do they attempt to estimate the value of anticipated future business related to the instruments. In addition, the tax ramifications related to the realization of unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of these estimates.

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

The following methods and assumptions were used by the Bank to estimate the fair value of its financial instruments at March 31, 2011 and December 31, 2010:

Cash and cash equivalents: For cash and cash equivalents, consisting of cash, due from banks and federal funds sold, the carrying amount is estimated to be fair value.

Investment securities: As discussed in greater detail in Note 6, for investment securities, fair values are based on quoted market prices, where available. If quoted market prices are not available, fair values are estimated using quoted market prices for similar securities and indications of value provided by brokers. The carrying amount of accrued interest receivable approximates its fair value.

Loans, net of allowance: For variable-rate loans that reprice frequently with no significant change in credit risk, fair values are based on carrying values. Fair values for other loans are estimated using discounted cash flow analyses, using interest rates being offered at each reporting date for loans with similar terms to borrowers of comparable creditworthiness (without considering widening credit spreads due to market illiquidity). The allowance for loan losses is considered to be a reasonable estimate of discount for credit risk. The carrying amount of accrued interest receivable approximates its fair value.

Federal Home Loan Bank stock: The fair value for Federal Home Loan Bank Stock is not determinable as there are restrictions on its transferability.

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

Short-term borrowings and long-term debt: The fair values of fixed rate borrowings are estimated using a discounted cash flow analysis that applies interest rates being offered on similar debt instruments. The fair values of

variable rate borrowings are based on carrying value. The carrying amount of accrued interest payable approximates its fair value.

Commitments to fund loans/standby letters of credit: The fair values of commitments are estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. The differences between the carrying value of commitments to fund loans or standby letters of credit and their fair value are not significant and, therefore, are not included in the following table.

(in thousands)	March 31, 2011		December 31, 2010	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:				
Cash and due from banks	\$ 9,486	\$ 9,486	\$ 4,542	\$ 4,542
Federal funds sold	-	-	7,940	7,940
Investment securities	61,084	61,084	33,642	33,642
Loans, net of allowance	280,284	298,528	280,398	300,071
Investment in FHLB stock	2,510	N/A	2,614	N/A
Accrued interest receivable	1,903	1,903	1,342	1,342
Financial liabilities:				
Deposits	\$ 300,108	\$ 301,682	\$ 279,977	\$ 281,565
FHLB advances	17,100	17,460	12,000	12,407
Accrued interest payable	122	122	122	122

8. INVESTMENT SECURITIES

The amortized costs and estimated fair value of investment securities at March 31, 2011 and December 31, 2010 consisted of the following:

(in thousands)	March 31, 2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Securities available -for-sale:				
Government agencies	\$ 43,147	\$ 600	\$ (283)	\$ 43,464
Mortgage-backed securities - residential	4,249	119	(79)	4,289
Corporate securities	13,445	7	(121)	13,331
Total securities available -for-sale	<u>\$ 60,841</u>	<u>\$ 726</u>	<u>\$ (483)</u>	<u>\$ 61,084</u>
(in thousands)	December 31, 2010			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Securities available -for-sale:				
Government agencies	\$ 29,185	\$ 447	\$ (324)	\$ 29,308
Mortgage-backed securities - residential	4,287	122	(75)	4,334
Total securities available -for-sale	<u>\$ 33,472</u>	<u>\$ 569</u>	<u>\$ (399)</u>	<u>\$ 33,642</u>

Net unrealized gains on available-for-sale investment securities totaling \$243,000 and \$170,000 are recorded, net of \$103,000 and \$72,000 in tax expense, as accumulated other comprehensive income within shareholders' equity at March 31, 2011 and December 31, 2010. There were no sales of available-for-sale securities for the three months ended March 31, 2011 and proceeds from the sale of available-for-sale securities totaled \$2,350,000 with gross gains of \$150,000 for the three months ended March 31, 2010.

Investment securities with unrealized losses at March 31, 2011 and December 31, 2010 are summarized and classified according to the duration of the loss period as follows:

March 31, 2011						
Less than 12 Months		12 Months or More		Total		
Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	
(in thousands)						
Debt Securities:						
Government agencies	\$ 18,500	\$ (283)	\$ -	\$ -	\$ 18,500	\$ (283)
Corporate securities	9,890	(121)	-	-	9,890	(121)
Mortgage-backed securities - residential	1,830	(79)	-	-	1,830	(79)
	<u>\$ 30,220</u>	<u>\$ (483)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 30,220</u>	<u>\$ (483)</u>

December 31, 2010						
Less than 12 Months		12 Months or More		Total		
Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	
(in thousands)						
Debt Securities:						
Government agencies	\$ 12,677	\$ (324)	\$ -	\$ -	\$ 12,677	\$ (324)
Mortgage-backed securities - residential	1,760	(75)	-	-	1,760	(75)
	<u>\$ 14,437</u>	<u>\$ (399)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 14,437</u>	<u>\$ (399)</u>

Management periodically evaluates each investment security for other than temporary impairment, relying primarily on industry analyst reports and observation of market conditions and interest rate fluctuations. The Bank had no other than temporary impairment losses (OTTI) in the consolidated statements of income for the three months ended March 31, 2011 and 2010.

The amortized cost and estimated fair value of investment securities at March 31, 2011 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.

(in thousands)	Available for Sale	
	Amortized Cost	Estimated Fair Value
Within one year	\$ -	\$ -
After one year through five years	1,992	1,991
After five years through ten years	34,241	34,212
After ten years	<u>20,359</u>	<u>20,592</u>
	56,592	56,795
Investment securities not due at a single maturity date:		
Mortgage-backed securities - residential	<u>4,249</u>	<u>4,289</u>
	<u>\$ 60,841</u>	<u>\$ 61,084</u>

9. LOANS

Outstanding loans are summarized as follows:

(in thousands)	March 31, 2011	December 31 2010
Real estate mortgage loans collateralized by:		
Real estate - commercial	\$ 126,505	\$119,267
Real estate - construction	5,084	4,803
Real estate - single family units	51,280	52,600
Real estate - multifamily	21,751	21,871
Real estate - land loans	11,374	7,331
Commercial & agricultural	66,641	75,925
Consumer	5,192	5,294
Lease financing	1,958	2,230
	<u>\$ 289,785</u>	<u>289,321</u>
Deferred loan fees, net	(2,778)	(2,865)
Allowance for loan losses	(6,723)	(6,058)
	<u><u>\$ 280,284</u></u>	<u><u>\$280,398</u></u>

Changes in the allocation of allowance for loan losses by loan class as follows:

(in thousands)

	Balance at December 31, 2010	Provision for loan losses	Charge-offs	Recoveries	Balance at March 31, 2011
Begning balance:					
Commercial & agricultural	\$ 1,485	406	\$ (78)	\$ 25	\$ 1,838
Real estate - commercial	1,402	405	-	-	1,807
Real estate - construction	509	450	-	-	959
Real estate - single family units	63	46	-	-	109
Real estate - multifamily	87	255	-	-	342
Real estate - land loans	1,382	(1,103)	-	-	279
Consumer	38	78	(82)	-	34
Lease financing	22	(3)	-	-	19
Other qualitative factors	960	-	-	-	960
Unallocated	110	266	-	-	376
Total	<u>\$ 6,058</u>	<u>\$ 800</u>	<u>\$ (160)</u>	<u>\$ 25</u>	<u>\$ 6,723</u>

(in thousands)

	Balance at December 31, 2009	Provision for loan losses	Charge-offs	Recoveries	Balance at March 31, 2010
Total	<u>\$ 4,737</u>	<u>\$ 1,010</u>	<u>\$ (325)</u>	<u>\$ -</u>	<u>\$ 5,422</u>

The following table presents the balance in the allowance for loan losses and loan balances by class and based on impairment method as of March 31, 2011 and December 31, 2010:

March 31, 2011						
(in thousands)	Allowance for Loan Losses:			Loans:		
	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total Ending Allowance Balance	Loans Individually Evaluated for Impairment	Loans Collectively Evaluated for Impairment	Total Ending Loans Balance
Commercial & agricultural	\$ 976	862	\$ 1,838	\$ 3,902	\$ 62,739	\$ 66,641
Real estate - commercial	952	855	1,807	15,955	110,550	126,505
Real estate - construction	935	24	959	2,357	2,727	5,084
Real estate - single family units	6	103	109	1,459	49,821	51,280
Real estate - multifamily	284	58	342	3,419	18,332	21,751
Real estate - land loans	-	279	279	6,715	4,659	11,374
Consumer	-	34	34	-	5,192	5,192
Lease financing	-	19	19	-	1,958	1,958
Other qualitative factors	-	960	960	-	-	-
Unallocated	-	376	376	-	-	-
Total	\$ 3,153	\$ 3,570	\$ 6,723	\$ 33,807	\$ 255,978	\$ 289,785

December 31, 2010						
(in thousands)	Allowance for Loan Losses:			Loans:		
	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total Ending Allowance Balance	Loans Individually Evaluated for Impairment	Loans Collectively Evaluated for Impairment	Total Ending Loans Balance
Commercial & agricultural	\$ 78	\$ 1,407	\$ 1,485	\$ 3,841	\$ 72,084	\$ 75,925
Real estate - commercial	592	810	1,402	11,199	108,068	119,267
Real estate - construction	487	22	509	2,357	2,446	4,803
Real estate - single family units	5	58	63	1,977	50,623	52,600
Real estate - multifamily	-	87	87	3,419	18,452	21,871
Real estate - land loans	878	504	1,382	6,342	989	7,331
Consumer	-	38	38	-	5,294	5,294
Lease financing	-	22	22	-	2,230	2,230
Other qualitative factors	-	960	960	-	-	-
Unallocated	-	110	110	-	-	-
Total	\$ 2,040	\$ 4,018	\$ 6,058	\$ 29,135	\$ 260,186	\$ 289,321

The recorded investment in the aforementioned disclosure and the next several disclosures do not include accrued interest receivable and net deferred fees because such amounts are not considered material. Accrued interest receivable for the total loan portfolio was \$1,197,000 and \$1,171,000 and net deferred loans fees was \$2,778,000 and \$2,865,000 as of March 31, 2011 and December 31, 2010.

The following table presents loans individually evaluated for impairment by class of loans as of March 31, 2011:

(in thousands)	Unpaid Principle Balance	Recorded Investment	Allowance for Loan Losses Allocation	Average Impaired Loans During The Period	Interest Recognized On Impaired Loans	Cash Basis Interest Income Recognized
With no related allowance recorded:						
Commercial & agricultural	\$ 1,694	\$ 1,694	\$ -	\$ 1,702	\$ 7	\$ 5
Real estate - commercial	5,749	5,749	-	5,776	104	90
Real estate - construction	-	-	-	-	-	-
Real estate - single family units	721	721	-	722	5	3
Real estate - multifamily	-	-	-	-	-	-
Real estate - land loans	6,715	6,715	-	6,728	88	68
Consumer	-	-	-	-	-	-
Lease financing	-	-	-	-	-	-
With an allowance recorded:						
Commercial & agricultural	2,208	2,208	976	2,221	45	33
Real estate - commercial	10,206	10,206	952	10,237	209	170
Real estate - construction	2,357	2,357	935	2,357	-	-
Real estate - single family units	738	738	6	739	11	8
Real estate - multifamily	3,419	3,419	284	3,419	-	-
Real estate - land loans	-	-	-	-	-	-
Consumer	-	-	-	-	-	-
Lease financing	-	-	-	-	-	-
Total	\$ 33,807	\$ 33,807	\$ 3,153	\$ 33,901	\$ 469	\$ 377

The following table presents loans individually evaluated for impairment by class of loans as of December 31, 2010:

(in thousands)	Unpaid Principle Balance	Recorded Investment	Allowance for Loan Losses Allocation
With no related allowance recorded:			
Commercial & agricultural	\$ 311	\$ 311	\$ -
Real estate - commercial	8,604	8,604	-
Real estate - construction	-	-	-
Real estate - single family units	1,018	1,018	-
Real estate - multifamily	3,419	3,419	-
Real estate - land loans	1,793	1,793	-
Consumer	-	-	-
Lease financing	-	-	-
With an allowance recorded:			
Commercial & agricultural	3,530	3,530	78
Real estate - commercial	2,595	2,595	592
Real estate - construction	2,357	2,357	487
Real estate - single family units	959	959	5
Real estate - multifamily	-	-	-
Real estate - land loans	4,549	4,549	878
Consumer	-	-	-
Lease financing	-	-	-
Total	\$ 29,135	\$ 29,135	\$ 2,040

At March 31, 2010, the unpaid principle balance of impaired loans was \$24,533,000, recorded investment was \$24,533,000, allowance for loan losses was \$977,000, interest recognized was \$207,000, and cash basis interest income was \$157,000.

The following tables present the recorded investment in nonaccrual loans and loans past due over 90 days still on accrual by class of loans as of March 31, 2011 and December 31, 2010:

(in thousands)	March 31, 2011		December 31, 2010	
	Nonaccrual	Loans Past Due Over 90 Days	Nonaccrual	Loans Past Due Over 90 Days
		Still Accruing		Still Accruing
Commercial & agricultural	\$ 1,430	\$ -	\$ 178	\$ -
Real estate - commercial	4,615	-	4,300	-
Real estate - construction	2,357	-	2,357	-
Real estate - single family units	213	-	295	-
Real estate - multifamily	3,419	-	-	-
Real estate - land loans	1,792	-	6,342	-
Consumer	-	-	-	-
Lease financing	-	-	-	-
Total	<u>\$ 13,826</u>	<u>\$ -</u>	<u>\$ 13,472</u>	<u>\$ -</u>

The following table presents the aging of the recorded investment in past due loans as of March 31, 2011 by class of loans:

(in thousands)	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Loans Not Past Due	Total
Commercial & agricultural	\$ -	\$ -	\$ 1,430	\$ 1,430	\$ 65,211	\$ 66,641
Real estate - commercial	-	-	4,615	4,615	121,890	126,505
Real estate - construction	-	-	2,357	2,357	2,727	5,084
Real estate - single family units	433	-	213	646	50,634	51,280
Real estate - multifamily	3,154	-	3,419	6,573	15,178	21,751
Real estate - land loans	-	-	1,792	1,792	9,582	11,374
Consumer	14	-	-	14	5,178	5,192
Lease financing	-	-	-	-	1,958	1,958
Total	<u>\$ 3,601</u>	<u>\$ -</u>	<u>\$ 13,826</u>	<u>\$ 17,427</u>	<u>\$ 272,358</u>	<u>\$ 289,785</u>

The following table presents the aging of the recorded investment in past due loans as of December 31, 2010 by class of loans:

(in thousands)	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Loans Not Past Due	Total
Commercial & agricultural	\$ -	\$ -	\$ 178	\$ 178	\$ 75,747	\$ 75,925
Real estate - commercial	-	-	4,300	4,300	114,967	119,267
Real estate - construction	-	-	2,357	2,357	2,446	4,803
Real estate - single family units	144	70	295	509	52,091	52,600
Real estate - multifamily	223	-	-	223	21,648	21,871
Real estate - land loans	-	-	6,342	6,342	989	7,331
Consumer	-	41	-	41	5,253	5,294
Lease financing	-	-	-	-	2,230	2,230
Total	<u>\$ 367</u>	<u>\$ 111</u>	<u>\$ 13,472</u>	<u>\$ 13,950</u>	<u>\$ 275,371</u>	<u>\$ 289,321</u>

Troubled Debt Restructurings

From time to time, the Bank may agree to modify the contractual terms of a borrower's loan. In cases where such modifications represent a concession to a borrower experiencing financial difficulty, the modification is considered a troubled debt restructuring ("TDR"). At March 31, 2011 and December 31, 2010, loans modified in a TDR totaled \$15,801,000 and \$13,164,000 which are included in the impaired loan disclosures above. The total TDRs includes \$7,966,000 and \$3,548,000 that are also included in nonperforming loans at March 31, 2011 and December 31, 2010. TDRs had specific loss allocations of \$1,707,000 and \$607,000 as of March 31, 2011 and December 31, 2010.

Credit Quality Indicators

The Bank categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Bank analyzes loans individually by classifying the loans as to credit risk. This analysis is performed on a monthly basis. The Bank uses the following definitions for risk ratings:

SPECIAL MENTION- Loans in this category are considered "criticized" from a regulatory point of view but are not considered "classified" until the risk classification becomes substandard or worse. Loans in this category represent above average risk and potential weakness which may, if not corrected, weaken the loan and threaten repayment at some future date.

SUBSTANDARD- Loans in this category have well defined weakness that jeopardize full repayment of the debt, although loss does not seem likely. Loss potential does not have to exist in individual loans in the Substandard classification, but will be apparent in the aggregate. Typically, these loans have not met repayment plans as agreed. The primary source of repayment may have failed to materialize; repayment may be dependent on collateral liquidation or other secondary sources. Bankrupt borrowers and those with continuously past due payments are considered substandard.

DOUBTFUL- Loans in this category have all the characteristics of substandard loans with the added weakness that payment in full or liquidation in full is highly questionable and improbable. The possibility of loss is extremely high, but because of certain important and reasonably specific pending factors, which may work to the strengthening of the loan, its classification as an estimated loss is deferred until the amount of the loss may be more accurately determined.

PASS- Loans not meeting any of the three criteria above that are analyzed individually as part of the above described process are considered to be pass rated loans.

Based on recent analysis performed, the risk category of loans by class of loans as of March 31, 2011 is as follows:

(in thousands)	Pass	Special Mention	Substandard	Doubtful	Not Rated	Total
Commercial & agricultural	\$ 61,587	\$ 403	\$ 4,651	\$ -	\$ -	\$ 66,641
Real estate - commercial	104,462	7,065	14,978	-	-	126,505
Real estate - construction	2,727	-	2,357	-	-	5,084
Real estate - single family units	50,418	144	718	-	-	51,280
Real estate - multifamily	18,332	-	3,419	-	-	21,751
Real estate - land loans	4,661	-	6,713	-	-	11,374
Consumer	2,511	737	1,944	-	-	5,192
Lease financing	1,958	-	-	-	-	1,958
Total	<u>\$ 246,656</u>	<u>\$ 8,349</u>	<u>\$ 34,780</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 289,785</u>

Based on recent analysis performed, the risk category of loans by class of loans as of December 31, 2010 is as follows:

(in thousands)	<u>Pass</u>	<u>Special Mention</u>	<u>Substandard</u>	<u>Doubtful</u>	<u>Not Rated</u>	<u>Total</u>
Commercial & agricultural	\$ 66,229	\$ 2,894	\$ 6,802	\$ -	\$ -	\$ 75,925
Real estate - commercial	99,378	6,393	13,496	-	-	119,267
Real estate - construction	2,446	-	2,357	-	-	4,803
Real estate - single family units	51,942	-	658	-	-	52,600
Real estate - multifamily	18,449	-	3,422	-	-	21,871
Real estate - land loans	2,237	-	5,094	-	-	7,331
Consumer	-	-	428	-	4,866	5,294
Lease financing	-	-	-	-	2,230	2,230
 Total	 <u>\$ 240,681</u>	 <u>\$ 9,287</u>	 <u>\$ 32,257</u>	 <u>\$ -</u>	 <u>\$ 7,096</u>	 <u>\$ 289,321</u>

10. SUBSEQUENT EVENT

On April 25, 2011, the Board of Directors declared a \$.09 per common share cash dividend to shareholders of record at the close of business on May 11, 2011, to be paid on May 23, 2011, and a preferred dividend of \$106,250 payable on May 16, 2011.

Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion provides additional information about the financial condition of the Bank at March 31, 2011 and December 31, 2010, and results of operations for the three months ended March 31, 2011 and 2010. The following analysis should be read in conjunction with the consolidated financial statements of the Bank and the notes thereto appearing elsewhere in the report, which were prepared in accordance with U.S. Generally Accepted Accounting Principles. The interim financial information provided as of and for the three months ended March 31, 2011 and 2010 are unaudited. In the opinion of management of the Bank, the interim financial information presented reflects all adjustments (consisting solely of normal recurring accruals) considered necessary for a fair representation of the results of such periods.

All references to yields, cost of liabilities and net interest margin are annualized for the periods discussed. References to preferred dividends include cash dividends declared on the preferred stock and accretion of preferred stock discount.

Forward Looking Statements. This discussion includes forward-looking statements within the meaning of the "safe harbor" provisions of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, that are based on the current beliefs of the Bank management as well as assumptions made by and information currently available to the Bank's management. When used in this discussion, the words "anticipate," "believe," "estimate," "expect," "should," "intend," "project," "may," "will," "would," variations of such words and words or phrases of similar meaning constitute forward-looking statements. Although the Bank believes that the expectations reflected in such forward-looking statements are reasonable, it can give no assurance that such expectations will prove to have been correct.

These forward-looking statements relate to, among other things, expectations regarding the business environment in which the Bank operates, projections of future performance, potential future performance, potential future credit experience, perceived opportunities in the market, and statements regarding the Bank's mission and vision. Factors which may cause actual results to vary from forward-looking statements include, but are not limited to, changes in interest rates, general economic and business conditions, changes in business strategy or development plans, changes in credit quality, the availability of capital to fund the expansion of our business, legislative and regulatory changes, government monetary and fiscal policies, real estate valuations, competition in the financial services industry, demographic changes, civil disturbances or terrorist threats or acts, or apprehension about the possible future occurrences of acts of this type, outbreak or escalation of hostilities in which the United States is involved, any declaration of war by the U.S. Congress or any other national or international calamity, crisis or emergency, and other risks referenced in this discussion.

This discussion contains certain forward-looking information about us. All statements other than statements of historical fact are forward-looking statements. Such statements involve inherent risks and uncertainties, many of which are difficult to predict and are generally beyond our control. We caution readers that a number of important factors could cause actual results to differ materially from those expressed in, implied or projected by, such forward-looking statements. Risks and uncertainties include, but are not limited to:

- lower revenues than expected;
- credit quality deterioration which could cause an increase in the provision for credit losses;
- competitive pressure among depository institutions increases significantly;
- the cost of additional capital is more than expected;
- a change in the interest rate environment reduces interest margins;
- asset/liability repricing risks and liquidity risks;
- legislative or regulatory requirements or changes adversely affecting our business;
- changes in the securities markets;
- general economic conditions, either nationally or in the market areas in which we do or anticipate doing business, are less favorable than expected;

- the economic and regulatory effects of the continuing war on terrorism and other events of war, including the wars in Iraq and Afghanistan;
- our ability to complete any future acquisitions, to successfully integrate acquired entities, or to achieve expected synergies and operating efficiencies within expected time-frames or at all;
- the integration of any future acquired businesses costs more, takes longer or is less successful than expected; and
- regulatory approvals for announced or future acquisitions cannot be obtained on the terms expected or on the anticipated schedule.

Also, other important factors that could cause actual results to differ materially from the Bank's expectations are disclosed under Item 1A. "RISK FACTORS," in our Registration Statement on Form 10, as amended (the "Form 10"), and in our Annual Report on Form 10-K on file with the Federal Deposit Insurance Corporation ("FDIC") and below under this "MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS – *Critical Accounting Policies*" and elsewhere in this report.

If any of these risks or uncertainties materializes, or if any of the assumptions underlying such forward-looking statements proves to be incorrect, our results could differ materially from those expressed in, implied or projected by, such forward-looking statements. We assume no obligation to update such forward-looking statements.

We caution that these statements are further qualified by important factors, in addition to those under "Risk Factors" in our Form 10 and in our Annual Report on Form 10-K and elsewhere in this report, which could cause actual results to differ significantly from those in the forward-looking statements, including, among other things, economic conditions and other risks.

Forward-looking statements are not guarantees of performance. By their nature, they involve risks, uncertainties and assumptions. Our future results and shareholder values may differ significantly from those expressed in these forward-looking statements. You are cautioned not to put undue reliance on any forward-looking statement. Any such statement speaks only as of the date of this discussion, regardless of the time of delivery of this document. We do not undertake any obligation to update or release any revisions to any forward-looking statements, to report any new information, future event or other circumstances after the date of this filing or to reflect the occurrence of unanticipated events, except as required by law. However, your attention is directed to any further disclosures made on related subjects in any subsequent reports we may file with the FDIC, including on Forms 10-K, 10-Q and 8-K.

Government and Regulatory Oversight. The Bank is subject to regulatory oversight by the Department of Financial Institutions (DFI) from the state of California and the Federal Deposit Insurance Corporation (FDIC). These regulatory bodies periodically perform financial examinations of the Bank with an effective date of an examination based on a prior quarter end period. There is a potential that an examination may derive different estimates than those reached by management and could require material adjustments or restatements.

Critical Accounting Policies. The discussion and analysis of the Bank's results of operations and financial condition are based upon financial statements which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires the Bank's management to make estimates and judgments that affect the reported amounts of assets and liabilities, income and expense, and the related disclosures of contingent assets and liabilities at the date of these financial statements.

The Bank believes these estimates and assumptions to be reasonably accurate; however, actual results may differ from these estimates under different assumptions or circumstances. Material estimates that are particularly susceptible to significant change in the near-term relate to the determination of the allowance for loan losses, consideration of goodwill impairment, and fair values of securities available for sale and consideration of potential other than temporary impairment.

The allowance for loan losses is determined first and foremost by promptly identifying potential credit weaknesses that could jeopardize repayment. The Bank's process for evaluating the adequacy of the allowance for loan losses includes determining estimated loss percentages for each credit based on the Bank's historical loss experience and other factors in the Bank's credit grading system and accompanying risk analysis for determining an adequate level of the allowance. The risks are assessed by rating each account based upon paying habits, loan to value ratio, financial condition and level of classifications. The allowance for loan losses was \$6,723,000 at March 31, 2011 and \$6,058,000 at December 31, 2010.

We assess the carrying value of our goodwill at least annually in order to determine if this intangible asset is impaired. In reviewing the carrying value of our goodwill, we assess the recoverability of such assets by evaluating the fair value of the related business unit. If the carrying amount of goodwill exceeds its fair value, an impairment loss is recognized for the amount of the excess and the carrying value of goodwill is reduced accordingly. Any impairment would be required to be recorded during the period identified. Accounting standards require an annual evaluation of goodwill for impairment using various estimates and assumptions. The market price of the Bank's common stock at the close of business on March 31, 2011 was \$6.98 per common share and the average closing prices for the first quarter of 2011 was \$6.71 per common share compared to a book value, net of preferred stock, of \$9.93 per common share at March 31, 2011. The Bank's management believes the lower market price per common share in relation to book value per common share is due to the overall decline in stock prices in the financial industry sector and is not specific to the Bank. The market price per common share has experienced high volatility and demonstrates the ability of the stock price to increase significantly in the near future.

Further, in September 2010, the Bank engaged an independent first party specialist to perform an impairment test of its goodwill. The evaluation included three approaches: 1) Multiple of tangible book value, based on recent bank acquisitions in California 2) Multiple of equity return and 3) Premium on deposits. The Bank took an average of these approaches and also considered the Bank's excess regulatory capital level above the required leverage capital ratio. The impairment test was performed as of September 21, 2010 based on June 30, 2010 data and resulted in an implied fair value for the Bank sufficiently above the book value to support the current carrying value of goodwill. As the Bank's stock price per common share is currently less than its book value per common share, it is reasonably possible that management may conclude that goodwill, totaling \$4.1 million at March 31, 2011, is impaired as a result of a future assessment. If our goodwill is determined to be impaired, the related charge to earnings could be material.

The fair values of most securities available for sale are determined by matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs).

We are obligated to assess, at each reporting date, whether there is an "other-than-temporary" impairment to our investment securities. Such impairment must be recognized in current earnings for equity securities and for debt securities, if related to credit losses, rather than in other comprehensive income or loss, net of tax. We examine all individual securities that are in an unrealized loss position at each reporting date for other-than-temporary impairment. Specific investment level factors we examine to assess impairment include the severity and duration of the unrealized loss, the nature, financial condition and results of operations of the issuers of the securities and whether there has been any cause for default on the securities or any adverse change in the rating of the securities by the various rating agencies as well as whether the decline in value is credit or liquidity related. Additionally, we reexamine our financial resources and our overall intent and ability to hold the securities until their fair values recover.

Earnings Summary
(In Thousands)

	Three Months Ended	
	March 31, 2011	March 31, 2010
	(Unaudited)	(Unaudited)
Statement of Income Data:		
Net interest income	\$ 3,943	\$ 3,880
Provision for loan losses	800	1,010
Non-interest income	262	427
Non-interest expense	2,592	2,379
Provision for income taxes	336	378
Net income	\$ 477	\$ 540
Less: preferred dividends	138	138
Net income available for common stockholders	\$ 339	\$ 402
 Selected per Common Share Data:		
Basic earnings per common share	\$ 0.07	\$ 0.08
Diluted earnings per common share	\$ 0.07	\$ 0.08
Book value per common share (2)(3)	\$ 9.94	\$ 10.04
 Selected Balance Sheet Data:		
Assets	\$ 374,118	\$ 350,148
Loans, net	280,284	284,890
Deposits	300,108	274,894
Average assets	357,169	344,689
Average earnings assets	343,008	327,788
Average shareholders' equity	55,500	55,864
Average common shareholders' equity	46,761	47,252
Nonperforming loans	13,826	11,442
Total nonperforming assets	14,294	11,537
 Selected Ratios:		
Return on average assets (1)	0.54%	0.64%
Return on average common equity (1)	2.94%	3.45%
Return on average common tangible equity (1)	3.22%	3.78%
Efficiency ratio	61.64%	55.24%
Net interest margin (1)	4.66%	4.80%
Tier 1 leverage capital ratio	14.5%	15.08%
Tier 1 risk-based capital ratio	17.3%	18.29%
Total risk-based capital ratio	18.6%	19.53%
Common dividend payout ratio (4)	125.96%	106.22%
Average equity to average assets	15.54%	16.21%
Nonperforming loans to total loans (2)	4.82%	3.94%
Nonperforming assets to total assets (2)	3.82%	3.29%
Allowance for loan losses to total loans (2)	2.34%	1.87%
Allowance for loan losses to nonperforming loans (2)	48.63%	47.39%

(1) Annualized.

(2) As of period end

(3) Total shareholders' equity less, preferred stock, divided by total common shares outstanding

(4) common dividends divided by net income available for common stockholders

Results of Operations

Three months ended March 31, 2011 and March 31, 2010

Net Income

The Bank reports “net income” which reflects the results of its operations for the periods and “net income available for common stockholders” which is net income less preferred stock dividends declared and accretion of preferred stock discount during the periods. The Bank issued 8,500 shares of preferred stock in December 2008 to the United States Department of the Treasury under the Capital Purchase Program (the “CPP”).

For the three months ended March 31, 2011, net income was \$477,000, and net income available for common stockholders was \$339,000 compared to net income of \$540,000 and net income available for common stockholders of \$402,000 for the three months ended March 31, 2010. Earnings per diluted common share were \$0.07 for the quarter ended March 31, 2011 compared to \$0.08 for the quarter ended March 31, 2010. Annualized return on average assets was 0.47% for the first quarter of 2011 compared to 0.64% for the first quarter of 2010.

Net Interest Income and Net Interest Margin

Net interest income increased \$63,000 or 1.6% to \$3,943,000 for the first quarter of 2011 compared to \$3,880,000 for the same quarter of 2010. The annualized net interest margin declined to 4.66% for the first quarter of 2011, compared to 4.80% for the first quarter of 2010.

The net interest margin declined as a result of impacts from the levels of nonaccrual loans, investment securities that are called or matured and are replaced at lower yields and lower yields on loans from the general decline in interest rates. These effects were partially offset with the decline in deposit and borrowing interest costs.

Average earning assets increased 4.6% to \$343,008,000 for the first quarter of 2011, as compared to \$327,788,000 for the same quarter of 2010. The annualized yield on average earning assets was 5.54% and the annualized cost of average interest-bearing liabilities was 1.10% for the first quarter of 2011, as compared to the annualized yield on average earning assets of 5.98% and annualized cost of interest-bearing liabilities of 1.43% for the same quarter of 2010.

The following table presents condensed average balance sheet information for the Bank, together with interest rates earned and paid on the various sources and uses of its funds for each of the periods presented. Average balances are based on daily average balances. Nonaccrual loans are included in loans with any interest collected reflected on a cash basis.

Average Balance Sheet and Analysis of Net Interest Income
(Dollars in thousands)

	Three Months Ended			Three Months Ended		
	March 31, 2011			March 31, 2010		
	Average Balance	Interest Income/ Expense	Average Rate (4)	Average Balance	Interest Income/ Expense	Average Rate (4)
Assets						
Interest earning assets:						
Interest bearing deposits in banks	\$ 5,698	\$ 2	0.14%	\$ 22	\$ -	0.00%
Taxable investment securities	45,595	436	3.88%	32,610	361	4.49%
Federal funds sold	8,355	5	0.24%	4,659	2	0.17%
Loans, net of unearned income (1)	283,360	4,245	6.08%	290,497	4,473	6.24%
Total earning assets/interest income	343,008	4,688	5.54%	327,788	4,836	5.98%
Non-earning assets	20,489			21,933		
Allowance for loan losses	(6,328)			(5,032)		
Total assets	\$ 357,169			\$ 344,689		
Liabilities and Shareholders' Equity						
Interest bearing liabilities:						
Deposits:						
Interest bearing demand deposits	\$ 25,154	17	0.27%	\$ 22,725	25	0.45%
Savings and money market	58,000	93	0.65%	52,238	135	1.05%
Time deposits	179,689	548	1.24%	176,330	660	1.52%
FHLB advances	13,039	87	2.71%	19,259	136	2.86%
Total interest bearing liabilities/interest expense	275,882	745	1.10%	270,552	956	1.43%
Non-interest bearing deposits	24,234			17,481		
Other liabilities	1,553			792		
Total liabilities	301,669			288,825		
Shareholders' equity	55,500			55,864		
Total liabilities and shareholders' equity	\$ 357,169			\$ 344,689		
Net interest income and margin (2)		\$ 3,943	4.66%		\$ 3,880	4.80%
Net interest spread (3)			4.44%			4.55%

- (1) The net amortization of deferred fees and costs on loans included in interest income was \$103,000 and \$166,000 for the three months ended March 31, 2011 and 2010, respectively.
- (2) Net interest margin is computed by dividing net interest income by average total earning assets.
- (3) Net interest spread is the difference between the average rate earned on average total earning assets and the average rate paid on average total interest bearing liabilities.
- (4) Annualized.

The following table shows the change in interest income and interest expense and the amount of change attributable to variances in volume and rates. The unallocated change in rate or volume variance has been allocated between the rate and volume variances in proportion to the absolute dollar amount of the change of each.

Volume and Yield/Rate Variances (Dollars in thousands)			
2011 Compared to 2010 for the Quarter Ended March 31,			
Change Due to			
	Net	Volume	Yield/Rate
Interest income:			
Interest bearing deposits in banks	\$ 2	\$ 2	\$ -
Taxable investment securities	75	14	61
Federal funds sold	3	(34)	37
Loans, net of unearned income (1)	(228)	548	(776)
Total interest income	(148)	530	(678)
Interest expense:			
Interest-bearing demand deposits	\$ (8)	3	(11)
Savings and money market	(42)	(23)	(19)
Time deposits	(112)	107	(219)
FHLB advances	(49)	76	(125)
Total interest expense	(211)	163	(374)
Increase (decrease) in net interest income	\$ 63	\$ 367	\$ (304)

Provision for Loan Losses

The Bank maintains an allowance for loan losses for probable incurred losses that are expected as an incidental part of the banking business. Write-offs of loans are charged against the allowance for loan losses, which is adjusted periodically to reflect changes in the volume of outstanding loans and estimated losses due to changes in the financial condition of borrowers or the value of property securing nonperforming loans, or changes in general economic conditions and other qualitative factors. Additions to the allowance for loan losses are made through a charge against income referred to as the “provision for loan losses”.

The Bank’s loan policy provides procedures designed to evaluate and assess the credit risk factors associated with the loan portfolio, to enable management to assess such credit risk factors prior to granting new loans and to evaluate the sufficiency of the allowance for loan losses. Management conducts an assessment of the allowance for loan losses on a monthly basis and undertakes a more critical evaluation quarterly. At the time of the quarterly review, the Board of Directors evaluates and formally approves the adequacy of the allowance. The quarterly evaluation includes an assessment of the following factors: any external loan review and regulatory examination, estimated probable loss exposure on each pool of loans, concentrations of credit, value of collateral, the level of delinquent and non-accruals loans, trends in loan volume, effects of any changes in the lending policies and procedures, changes in lending personnel, current economic conditions at the local, state and national level, and a migration analysis of historical losses and recoveries for the prior eight quarters.

For the three months ended March 31, 2011, the provision for loan losses was \$800,000 compared to \$1,010,000 for the three months ended March 31, 2010. The provision for loan losses reflects changes in specific allowance allocations for impaired loans, changes in the general real estate economy and adjustments in various qualitative factors related to measurement of the adequacy of the allowance for loan losses. During the three months ended March 31, 2011, there were \$160,000 loan charge-offs compared to \$325,000 for the three months ended March 31, 2010. There was \$25,000 in loan recoveries during the three months ended March 31, 2011, and \$0 for the same period in 2010. Specific allowance allocations for impaired loans totaled \$3,153,000 at March 31, 2011 and \$2,040,000 at December 31, 2010. The provisions for loan losses for the periods reflect management’s assessment

of the negative current economic trends and of the net loan charge-offs during 2011 and 2010. See Balance Sheet Activity – Nonperforming Assets and Allowance for Loan Losses for additional discussion.

Non-interest Income

Non-interest income totaled \$262,000 and \$427,000 for the first quarter of 2011 and 2010. Non-interest income consists primarily of service charges on deposit accounts, office lease income and net security gains. Service charges on deposit accounts were \$117,000 for the first quarter of 2011 compared to \$93,000 for the same quarter in 2010. Office lease income was \$138,000 and \$126,000 for the first quarter of 2011 and 2010.

The Bank recognized \$150,000 in net gains on security sales during the first quarter 2010. There were no securities sales in the first quarter of 2011.

Non-interest Expense

For the first quarter of 2011, non-interest expense increased \$213,000, or 9%, to \$2,592,000, compared to \$2,379,000 for the same quarter in 2010.

Salaries and employee benefits expense increased \$80,000 for the quarter ended March 31, 2011, or 6.4%, compared to the same period in 2010, primarily due to salary and health care insurance costs increases. Other operating expenses increased by \$132,000 or 17.6% for 2011 compared to first quarter 2010 primarily due to maintenance expenses incurred on the head office building of \$107,000.

Provision for Income Taxes

The Bank accrues income tax expense based on the anticipated tax rates during the financial period covered. The provision for income taxes and effective combined Federal and State corporate income tax rates for the three months ended March 31, 2011 were \$336,000 (41.3%) compared to \$378,000 (41.2%) for the same period ended March 31, 2010.

Balance Sheet Activity

At March 31, 2011 and December 31, 2010

Investment Portfolio

Securities classified as available-for-sale for accounting purposes are recorded at their fair value on the balance sheet. Available-for-sale investment securities carried at fair value totaled \$61,084,000 at March 31, 2011 and comprised 16.3% of total assets compared to amortized cost of \$60,841,000. At December 31, 2010, investment securities comprised 9.7% of total assets with a fair value of \$33,642,000 and amortized cost of \$33,472,000. Changes in the fair value of available-for-sale securities (e.g., unrealized holding gains or losses) are reported as “other comprehensive income (loss),” net of tax, and carried as accumulated other comprehensive income or loss, net of tax, within shareholders’ equity until realized unless any declines in value below amortized cost are the result of other than temporary impairment.

There were \$27,653,000 and \$5,547,000 in par value purchases of government agency bonds, corporate bonds and Fannie Mae guaranteed mortgage backed securities during the three months ended March 31, 2011 and 2010, respectively. The Bank sold \$2,200,000 in corporate debt securities in the first quarter of 2010 for a net gain of \$150,000. There were no security sales in the first quarter of 2011. At March 31, 2011, securities with par value of \$11,000,000 were callable within one year. In the first quarter of 2011, the Bank started to increase its investment portfolio with a mix of government agency and corporate debt securities to increase the earning asset base and the Bank’s liquidity position.

The Bank utilizes the investment portfolio to manage liquidity and attract funding that requires collateralization. At March 31, 2011, investment securities with fair value of \$28,588,000, or 47% of the investment portfolio, were pledged to secure time deposits from the State of California. At December 31, 2010, investment securities with fair value of \$28,058,000, or 83% of the investment portfolio, were pledged.

The Bank does not own securities of any single issuer (other than U.S. Government agencies and corporations) whose aggregate book value was in excess of 10% of the Bank’s total shareholders’ equity at the time of purchase.

Loan Portfolio

The following table shows the composition of the loan portfolio by amount, percentage of total loans for each major loan category and the dollar volume and percentage change between the dates indicated.

(in thousands)	<u>March 31, 2011</u>		<u>December 31, 2010</u>		<u>Net Change</u>	<u>Percent Change</u>
		%		%		
Commercial & agricultural	\$ 66,641	23.0%	\$ 75,925	26.2%	\$ (9,284)	-12.2%
Real Estate - commercial	126,505	43.6%	119,267	41.2%	7,238	6.1%
Real estate - construction	5,084	1.8%	4,803	1.7%	281	5.9%
Real Estate - single family units	51,280	17.7%	52,600	18.2%	(1,320)	-2.5%
Real estate - multifamily	21,751	7.5%	21,871	7.6%	(120)	-0.5%
Real estate - land loans	11,374	3.9%	7,331	2.5%	4,043	55.1%
Consumer	5,192	1.8%	5,294	1.8%	(102)	-1.9%
Lease financing	1,958	0.7%	2,230	0.8%	(272)	-12.2%
	<u>289,785</u>	<u>100%</u>	<u>289,321</u>	<u>100%</u>	<u>464</u>	<u>0.2%</u>
<u>LESS:</u>						
Allowance for Loan Losses	(6,723)		(6,058)		(665)	11.0%
Deferred Loan Fees	(2,778)		(2,865)		87	-3.0%
Total Loans, Net	<u>\$ 280,284</u>		<u>\$ 280,398</u>		<u>\$ (114)</u>	<u>0.0%</u>

At March 31, 2011, the Bank had approximately \$14,683,000 in undisbursed loan commitments, of which approximately \$1,483,000 related to real estate construction, land and commercial real estate loans. At December 31, 2010, the Bank had approximately \$12,483,000 in undisbursed loan commitments, of which approximately \$3,065,000 related to real estate construction loans and commercial real estate loans.

Nonperforming Assets

Nonperforming assets consist of nonperforming loans, investment securities with deferred interest payments and other real estate owned. Nonperforming loans are those for which the borrower fails to perform under the original terms of the obligation and consist of nonaccrual loans, accruing loans past due 90 days or more and restructured loans, if applicable.

The following are the nonperforming assets for the respective periods:

Nonperforming Loans and Assets

(in thousands)	March 31, 2011	December 31, 2010
Nonaccrual loans	\$ 13,826	\$13,472
Accruing loans past due 90 days or more	-	-
Total nonperforming loans	13,826	13,472
Other real estate owned	468	-
Total nonperforming assets	\$ 14,294	\$13,472
Nonperforming loans to total loans	4.82%	4.70%
Nonperforming assets to total assets	3.82%	3.87%

Nonperforming loans at March 31, 2011 consisted of seventeen loans to ten relationships. The balances are primarily secured by real property. There were \$15,801,000 and \$13,164,000 in loans classified as troubled debt restructurings (TDR) at March 31, 2011 and December 31, 2010. The total of TDRs includes \$7,966,000 and \$3,548,000 at March 31, 2011 and December 31, 2010, that are included in the nonperforming loans above.

Other real estate owned represents two foreclosed properties. One is a single family residence and the other a commercial property.

Allowance for Loan Losses

The Bank maintains the allowance for loan losses to provide for inherent losses in the loan portfolio. Additions to the allowance for loan losses are established through a provision for loan losses charged to expense. All loans which are judged to be uncollectible are charged against the allowance while any recoveries are credited to the allowance. The Bank's policy is to charge off any known losses at the time of determination. Any unsecured loan more than 90 days delinquent in payment of principal or interest and not in the process of collection is charged off in total. Secured loans are evaluated on a case by case basis to determine the ultimate loss potential to us subsequent to the liquidation of collateral. In those cases where we believe we are inadequately protected, a charge off will be made to reduce the loan balance to a level equal to the liquidation value of the collateral.

The Bank's loan policy provides procedures designed to evaluate and assess the credit risk factors associated with the loan portfolio, to enable management to assess such credit risk factors prior to granting new loans and to evaluate the sufficiency of the allowance for loan losses. Management conducts an assessment of the allowance for loan losses on a monthly basis and undertakes a more critical evaluation quarterly. At the time of the quarterly review, the Board of Directors evaluates and formally approves the adequacy of the allowance. The quarterly evaluation includes an assessment of the following factors: any external loan review and regulatory examination, estimated probable incurred loss exposure on each pool of loans, concentrations of credit, value of collateral, the level of delinquent and non-accrual loans, trends in loan volume, effects of any changes in lending policies and procedures, changes in lending personnel, current economic conditions at the local, state and national level and a migration analysis of historical losses and recoveries for the prior eight quarters.

In addition to the allowance for loan losses, the Bank maintains an allowance for undisbursed loan commitments of \$32,000 reported in other liabilities on the consolidated balances sheet as of March 31, 2011 and December 31, 2010.

The allowance for loan losses was \$6,723,000 at March 31, 2011 compared to \$6,058,000 at December 31, 2010. The activity in the allowance for loan losses during the first quarter of 2011 included a provision for loan losses of \$800,000, charge-offs of \$160,000 and recoveries of \$25,000. At March 31, 2011, and December 31, 2010, the Bank's allowance for loan losses was 2.34% and 2.11% of outstanding loans, respectively.

The economic conditions and depressed real estate market will likely continue to place stress on borrowing customers of the Bank. The provision for loan losses in future quarters may vary significantly from quarter to quarter as the economic impacts on particular borrowers is realized.

The following table summarizes the activity in the Allowance for Loan Losses during the periods indicated.

SUMMARY OF ACTIVITY IN ALLOWANCE FOR LOAN LOSSES
(Dollars in thousands)

	<u>Three Months Ended</u> March 31, 2011	<u>Year Ended</u> December 31, 2010
Balance at beginning of period	\$ 6,058	\$ 4,737
Charge-offs:		
Commercial & agricultural	78	1,987
Real estate--construction and land development	-	270
Real estate--mortgage		242
Consumer	82	56
Lease financing	-	-
Total loans charged-off	<u>160</u>	<u>2,555</u>
Recoveries:		
Commercial & agricultural	25	-
Real estate--construction and land development	-	14
Real estate--mortgage	-	-
Consumer	-	2
Lease financing	-	-
Total recoveries	<u>25</u>	<u>16</u>
Net loans charged-off	135	2,539
Provision for loan losses	800	3,860
Allowance for loan losses - end of period	<u>\$ 6,723</u>	<u>\$ 6,058</u>
Loans:		
Average loans outstanding during period, net of unearned income	\$ 283,360	\$ 287,929
Total loans at end of period, net of unearned income	\$ 287,007	\$ 286,456
Ratios:		
Net loans charged-off to average net loans (1)	0.19%	0.88%
Net loans charged-off to total loans (1)	0.19%	0.89%
Allowance for loan losses to average net loans	2.37%	2.10%
Allowance for loan losses to total loans	2.34%	2.11%
Net loans charged-off to beginning allowance for loan losses (1)	9.04%	53.60%
Net loans charged-off to provision for loan losses	16.88%	65.78%
(1) Annualized for three months ended March 31, 2011		

Allocation of Allowance for Loan Losses

(in thousands)	March 31,		December 31,	
	2011		2010	
	Allowance Allocation	Amount of Category Loans to Total Loans	Allowance Allocation	Amount of Category Loans to Total Loans
Commercial & agricultural	\$ 1,838	23.0%	\$ 1,485	26.2%
Real estate - commercial	1,807	43.6%	1,402	41.2%
Real estate - construction	959	1.8%	509	1.7%
Real estate - single family units	109	17.7%	63	18.2%
Real estate - multifamily	342	7.5%	87	7.6%
Real estate - land loans	279	3.9%	1,382	2.5%
Consumer	34	1.8%	38	1.8%
Lease financing	19	0.7%	22	0.8%
Other qualitative factors	960		960	
Unallocated	376		110	
Total	\$ 6,723	100%	\$ 6,058	100%

The allowance allocation to real estate loan categories is highly dependent on the estimated real estate collateral values that secure specific troubled loans. The specific loans being evaluated at one period versus another can result in variations in the allocations. The changes in allocations of the allowance for loan losses to the commercial and agricultural, the real estate-commercial and real estate construction portfolios at March 31, 2011 as compared to December 31, 2010, was primarily attributable to the changes in the economy and its effect on particular borrowers and the current valuations of collateral. The decrease in allowance allocation to land loans was primarily due to the evaluation of the collateral values supporting the loans outstanding.

The allocation of the allowance for loan losses to the other qualitative factors category is due to management's assessment of various qualitative factors. Qualitative factors included the size of individual credits, concentrations and general economic conditions. Management also considers these qualitative factors in their evaluation of the adequacy of the allowance for loan losses. An unallocated allowance can arise from fluctuations in the amount of classified and nonperforming loans ("changes in credit grades") between periods. The Internal Asset Review Committee reviews the amount and reasons for unallocated allowances and whether it has arisen due to periodic fluctuations in the credit grades or has arisen due to changes in qualitative factors or changes in lending strategies. If the unallocated allowance has arisen from other than periodic fluctuations in credit grades, then the Internal Asset Review Committee may determine that a portion of the allowance for loan losses should be reversed. The unallocated allowance represents temporary changes in allocations resulting from changes in loan volumes, types and quality, as well as other factors. Management assesses the unallocated amount to determine if the amount is due to other than temporary changes in these factors.

Deposits

At March 31, 2011, the Bank had a deposit mix of 62% in time deposits, 20% in money market and savings accounts, and 18% in demand accounts. At December 31, 2010, the Bank had a deposit mix of 64% in time deposits, 19% in money market and savings accounts, and 17% in demand accounts.

At March 31, 2011 and December 31, 2010, the State of California had \$31,500,000 in time deposits with the Bank with maturities of 3 months and collateralized by investment securities and mortgage loans. These deposits are received through a program run by the Treasurer of the State of California to place public deposits with community banks. At March 31, 2011 the Bank had \$43,276,000 in brokered time deposits. This compares to \$53,345,000 in brokered time deposits at December 31, 2010. The brokered deposits are opened with maturities generally with maturity terms exceeding one year. The brokered deposits included \$24,127,000 in wholesale brokered deposits and \$10,239,000 of deposits placed by third party intermediaries at March 31, 2011 compared to \$32,127,000 in wholesale brokered deposits and \$12,980,000 at December 31, 2010. The remaining brokered deposits of \$8,910,000 at March 31, 2011 and \$8,238,000 at December 31, 2010 were raised locally from the Bank's customers

through a reciprocal deposit placement service called CDARS which is classified as brokered deposits for FFIEC Call Report purposes.

Liquidity and Capital Resources

Maintenance of adequate liquidity requires that sufficient resources be available at all times to meet cash flow requirements of the Bank. Liquidity in a banking institution is required primarily to provide for deposit withdrawals and the credit needs of customers and to take advantage of investment opportunities as they arise. A bank may achieve desired liquidity from both assets and liabilities. Cash and deposits held in other banks, Federal funds sold, other short term investments, maturing loans and investments, payments of principal and interest on loans and investments, and potential loan and investment securities sales are sources of asset liquidity. Deposit growth and access to credit lines established with correspondent banks, primarily with the FHLB, and access to brokered certificates of deposit are sources of liability liquidity. The Bank reviews its liquidity position on a regular basis based upon its current position and expected trends of loans and deposits. Management believes that the Bank maintains adequate sources of liquidity to meet its liquidity needs.

The Bank's liquid assets, defined as cash and cash equivalents, demand deposits with banks and the carrying value of unpledged available-for-sale investment securities, totaled \$41,982,000 and constituted 11% of total assets at March 31, 2011 compared to \$18,066,000 or 5.2% of total assets at December 31, 2010. The increase in liquid assets was the result of management's decision to increase balance sheet liquidity through an increase in deposits and borrowings from the FHLB, which were primarily invested in investment securities. See Balance Sheet Activity – Investment Portfolio for additional discussion.

Although the Bank's sources of liquidity include liquid assets, the Bank maintains lines of credit with the Federal Home Loan Bank and other correspondent banks. The total of these lines of credit was \$89 million at March 31, 2011 and December 31, 2010, of which \$17 million in Federal Home Loan Bank advances were outstanding at March 31, 2011 and \$12 million were outstanding at December 31, 2010. The Bank actively utilizes its borrowing capacity with the Federal Home Loan Bank to manage liquidity as well as to provide a funding alternative to time deposits, if the Federal Home Loan Bank's interest rates and terms are more favorable. The advances from the Federal Home Loan Bank can have maturities from overnight to multiple years.

Federal regulations establish guidelines for calculating "risk-adjusted" capital ratios and minimum ratio requirements. Under these regulations, banks are required to maintain a total risk-based capital ratio of 8.0% and Tier 1 risk-based capital ratio (primarily shareholders' equity less goodwill) of at least 4.0% of risk-weighted assets. The Bank had total and Tier 1 risk-based capital ratios of 18.6% and 17.3% at March 31, 2011, and was "well-capitalized" under the regulatory guidelines.

In addition, regulators have adopted a minimum leverage ratio standard for Tier 1 capital to average total assets. The minimum ratio for top-rated institutions may be as low as 3%. However, regulatory agencies have stated that most institutions should maintain ratios at least 1 to 2 percentage points above the 3% minimum. As of March 31, 2011, the Bank's leverage ratio was 14.4%. Capital levels for the Bank remain above established regulatory capital requirements. The policy of the Bank's Board of Directors is to maintain sufficient capital at not less than the "well-capitalized" thresholds established by banking regulators.

On December 19, 2008, the Bank issued 8,500 preferred stock shares to the United States Department of the Treasury under the Capital Purchase Program (the "CPP") raising \$8,500,000 in additional capital. Participation in the CPP was encouraged by the Bank's various regulatory agencies to strengthen bank capital ratios due to the uncertainty of the economic environment. Application for participation in the CPP had an expiration date set by the U.S. Treasury of November 14, 2008. The Bank's Board of Directors decided to participate in the CPP and increase the Bank's capital ratios based on the uncertainty of the economy and consideration of the potential for expansion with access to the additional capital. Subsequent to the issuance of the preferred stock, the U.S. Treasury has issued various regulations that impact the Bank. Additionally, there was a warrant issued to the U.S. Treasury for 239,212 shares of the Bank's common stock at a purchase price of \$5.33 per share. The outlook for the general economy continues to be uncertain with state and local government budgets under stress and rising unemployment and declining real estate values. The Bank's Board of Directors regularly evaluates the purpose and need for the preferred stock which may be redeemed at any time at the request of the Bank and approval of the FDIC.

Impact of Inflation

The primary impact of inflation on the Bank is its effect on interest rates. The Bank's primary source of income is net interest income, which is affected by changes in interest rates. The Bank attempts to limit the impact of inflation on its net interest margin through management of rate-sensitive assets and liabilities and analyses of interest rate sensitivity. The effect of inflation on premises and equipment as well as on non-interest expenses has not been significant for the periods presented.

Item 3 Quantitative and Qualitative Disclosures about Market Risk

Proper management of the rate sensitivity and maturities of assets and liabilities is required to provide an optimum and stable net interest margin. Interest rate sensitivity spread management is an important tool for achieving this objective and for developing ways in which to improve profitability. Management has assessed its market risk at March 31, 2011, and believes that there has been no material changes since December 31, 2010 except for the additional investment securities purchased in the first quarter of 2011. The securities purchased included U.S. Government agency and corporate debt securities with maturities of five to 10 years.

The Bank constantly monitors earning asset and deposit levels, developments and trends in interest rates, liquidity, capital adequacy and marketplace opportunities. Management responds to all of these to protect and possibly enhance net interest income while managing risks within acceptable levels as set forth in the Bank's policies. In addition, alternative business plans and transactions are contemplated for their potential impact. This process is known as asset/liability management and is carried out by changing the maturities and relative proportions of the various types of loans, investments, deposits and borrowings in the ways described above.

The tool most commonly used to manage and analyze the interest rate sensitivity of a bank is known as a computer simulation model. To quantify the extent of risks in both the Bank's current position and in transactions it might make in the future, the Bank uses a model to simulate the impact of different interest rate scenarios on net interest income. The hypothetical impact of sudden shock (generally, an immediate change in interest rates of +/- 2.00%) and smaller incremental interest rate changes are modeled quarterly, representing the primary means the Bank uses for interest rate risk management decisions. The Bank is liability sensitive; that is, more liabilities reprice within one year than assets. The expectation for a liability sensitive bank is that the net interest margin will decline in a rising interest rate environment.

When preparing its modeling, the Bank makes significant assumptions about the lag in the rate of change in various asset and liability categories. The Bank bases its assumptions on past experience and comparisons with other banks, and tests the validity of its assumptions by reviewing actual results with projected expectations.

Item 4 Controls and Procedures

Under the supervision and with the participation of the Bank's management, including its Chief Executive Officer and Chief Financial Officer, the Bank conducted an evaluation of the effectiveness of the design and operation of its disclosure controls and procedures as defined by Rule 13a-15(e) under the Securities Exchange Act of 1934.

Based on the evaluation, the Chief Executive Officer and Chief Financial Officer concluded that as of the end of the period covered by this report the disclosure controls and procedures were adequate and effective, and that the material information required to be included in this report, including information from the Bank's consolidated subsidiary, was properly recorded, processed, summarized and reported, and was made known to the Chief Executive Officer and Chief Financial Officer by others within the Bank in a timely manner, particularly during the period when this quarterly report on Form 10-Q was being prepared.

There was no change in the Bank's internal control over financial reporting that occurred during the most recent fiscal quarter that materially affected, or is reasonably likely to materially affect, internal control over financial reporting.

PART II OTHER INFORMATION

Item 1 Legal Proceedings

There is no pending, or to management's knowledge any threatened, material legal proceedings to which the Bank is a party or to which any of the Bank's properties are subject.

Item 1A Risk Factors

None.

Item 2 Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3 Defaults Upon Senior Securities

None.

Item 4 [Removed and Reserved]

None.

Item 5 Other Information

None.

Item 6 Exhibits

The exhibits filed as part of this report are listed on the Exhibit Index filed as part of this report.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Summit State Bank

(registrant)

May 10, 2011

/s/ Thomas M. Duryea

Date

Thomas M. Duryea, President & Chief Executive Officer

May 10, 2011

/s/ Dennis E. Kelley

Date

Dennis E. Kelley, SVP & Chief Financial Officer

EXHIBIT INDEX

Exhibit Number	Description
31.01	Certification of Principal Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) as adopted pursuant to §302 of the Sarbanes-Oxley Act of 2002
31.02	Certification of Principal Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) as adopted pursuant to §302 of the Sarbanes-Oxley Act of 2002
32.01	Certification of Principal Executive Officer and Principal Financial Officer pursuant to 18 U.S.C. §1350 as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002

Exhibit 31.01

Certification of Principal Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) as adopted pursuant to §302 of the Sarbanes-Oxley Act of 2002

I, Thomas M. Duryea, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Summit State Bank (the registrant) for the quarter ended March 31, 2011;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiary, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusion about the effectiveness of the disclosure controls procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

May 10, 2011 _____ /s/ Thomas M. Duryea

Date	Thomas M. Duryea President & Chief Executive Officer Summit State Bank
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Exhibit 31.02

Certification of Principal Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) as adopted pursuant to §302 of the Sarbanes-Oxley Act of 2002

I, Dennis E. Kelley, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Summit State Bank (the registrant) for the quarter ended March 31, 2011;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiary, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

May 10, 2011 /s/ Dennis E. Kelley

Date

Dennis E. Kelley
Senior Vice President
& Chief Financial Officer
Summit State Bank

EXHIBIT 32.01

Certification of Principal Executive Officer and Principal Financial Officer pursuant to 18 U.S.C. §1350 as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002

In connection with the quarterly report on Form 10-Q of Summit State Bank (the Registrant) for the quarter ended March 31, 2011, as filed with the Federal Deposit Insurance Corporation, the undersigned hereby certify pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

- 1) such Form 10-Q fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- 2) the information contained in such Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

May 10, 2011 /s/ Thomas M. Duryea
Thomas M. Duryea, Chief Executive Officer

May 10, 2011 /s/ Dennis E. Kelley
Dennis E. Kelley, Chief Financial Officer

This certification accompanies each report pursuant to §906 of the Sarbanes-Oxley Act of 2002 and shall not, except to the extent required by the Sarbanes-Oxley Act of 2002, be deemed filed by the Registrant for purposes of §18 of the Securities Exchange Act of 1934, as amended.