FIRST NORTHERN COMMUNITY BANCORP
Form 10-K
March 16, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

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

For the Fiscal Year Ended December 31, 2008
OR
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _________ to __________.

Commission File Number 000-30707
First Northern Community Bancorp
(Exact name of Registrant as specified in its charter)

California	68-0450397
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

195 N. First St., Dixon, CA	95620
(Address of principal executive offices)	(Zip Code)

707-678-3041
(Registrant's telephone number including area code)

Securities registered pursuant to Section 12(b) of the Act:	None
Securities registered pursuant to Section 12(g) of the Act:	Common Stock, no par value (Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes o No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act.
Yes o No x

Indicate by check mark whether the registrant (1) has filed all reports required 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 x No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (Section 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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 definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer o Accelerated filer x Non-accelerated filer o Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes o No x

The aggregate market value of the Common Stock held by non-affiliates of the registrant on June 30, 2008 (based upon the last reported sales price of such stock on the OTC Bulletin Board on June 30, 2008) was $103,291,164.

The number of shares of Common Stock outstanding as of March 12, 2009 was 8,654,288.

DOCUMENTS INCORPORATED BY REFERENCE

Items 10, 11, 12 (as to security ownership of certain beneficial owners and management), 13 and 14 of Part III incorporate by reference information from the registrant's proxy statement to be filed with the Securities and Exchange Commission in connection with the solicitation of proxies for the registrant's 2009 Annual Meeting of Shareholders

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This Annual Report on Form 10-K contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, which are subject to the "safe harbor" created by those sections. Forward-looking statements include the information concerning possible or assumed future results of operations of the Company set forth under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations." Forward-looking statements can be identified by the fact that they do not relate strictly to historical or current facts. Often they include words such as "expect," "anticipate," "intend," "plan," "believe," estimate," "consider," or words of similar meaning, or future or conditional verbs such as "w "would", "should", "could", "might", or "may. These forward-looking statements involve certain risks and uncertainties th could cause actual results to differ materially from those in the forward-looking statements. Such risks and uncertainties include, but are not limited to, the risks discussed in Part I, Item 1A under the caption "Risk Factors" and other risk factors discussed elsewhere in this Report. All of these forward-looking statements are based on assumptions about an uncertain future and are based on information available to us at the date of these statements. The Company undertakes no obligation to update any forward-looking statements to reflect events or circumstances arising after the date on which they are made.

PART I

ITEM 1 - BUSINESS

Unless otherwise indicated, all information herein has been adjusted to give effect to our two-for-one stock split in 2005 and stock dividends.

First Northern Bank of Dixon ("First Northern" or the "Bank") was established in 1910 under a California state charter as Northern Solano Bank, and opened for business on February 1st of that year. On January 2, 1912, the First National Bank of Dixon was established under a federal charter, and until 1955, the two entities operated side by side under the same roof and with the same management. In an effort to increase efficiency of operation, reduce operating expense, and improve lending capacity, the two banks were consolidated on April 8, 1955, with the First National Bank of Dixon as the surviving entity.

On January 1, 1980, the Bank's federal charter was relinquished in favor of a California state charter, and the Bank's name was changed to First Northern Bank of Dixon.

In April of 2000, the shareholders of First Northern approved a corporate reorganization, which provided for the creation of a bank holding company, First Northern Community Bancorp (the "Company"). The objective of this reorganization, which was effected May 19, 2000, was to enable the Bank to better compete and grow in its competitive and rapidly changing marketplace. As a result of the reorganization, the Bank is a wholly owned and principal operating subsidiary of the Company.

First Northern engages in the general commercial banking business throughout the California Counties of Solano, Yolo, Placer and Sacramento.

The Company's and the Bank's Administrative Offices are located in Dixon, California. Also located in Dixon are the back office functions of the Information Services/Central Operations Department and the Central Loan Department.

The Bank has eleven full service branches. Four are located in the Solano County cities of Dixon, Fairfield, and Vacaville (2). Four branches are located in the Yolo County cities of Winters, Davis, West Sacramento and Woodland. One branch is located in Downtown Sacramento in Sacramento County, and one branch is located in the city of Roseville in Placer County. The Bank also has two satellite banking offices inside retirement communities in the city of Davis. In addition, the Bank has real estate loan offices in Davis, Folsom and Roseville that originate residential mortgages and construction loans. The Bank also has a Small Business Administration (“SBA”) Loan Department and an Asset Management & Trust Department in Downtown Sacramento that serve the Bank’s entire market area.

First Northern is in the commercial banking business, which includes accepting demand, interest bearing transaction, savings, and time deposits, and making commercial, consumer, and real estate related loans. It also offers installment note collection, issues cashier’s checks, sells travelers’ checks, rents safe deposit boxes, and provides other customary banking services. The Bank is a member of the Federal Deposit Insurance Corporation (“FDIC”) and each depositor’s account is insured up to $250,000 through December 31, 2009 at which time the insurance coverage is expected to return to $100,000.

First Northern also offers a broad range of alternative investment products and services. The Bank offers these services through an arrangement with Raymond James Financial Services, Inc., an independent broker/dealer and a member of NASD and SIPC. All investments and/or financial services offered by representatives of Raymond James Financial Services, Inc. are not insured by the FDIC.

The Bank offers equipment leasing and limited international banking services through third parties.

The operating policy of the Bank since its inception has emphasized serving the banking needs of individuals and small- to medium-sized businesses. In Dixon, this has included businesses involved in crop and livestock production. Historically, the economy of the Dixon area has been primarily dependent upon agricultural related sources of income and most employment opportunities have also been related to agriculture. Since 2000, Dixon has been growing and becoming more diverse with noticeable expansion in the areas of industrial, commercial, retail and residential housing projects.

Agriculture continued to be a significant factor in the Bank's business after the opening of the first branch office in Winters in 1970. A significant step was taken in 1976 to reduce the Company's dependence on agriculture with the opening of the Davis Branch.

The Davis economy is supported significantly by the University of California, Davis. In 1981, a branch was opened in South Davis, and was consolidated into the main Davis Branch in 1986.

In 1983, the West Sacramento Branch was opened. The West Sacramento economy is built primarily around transportation and distribution related business. This addition to the Bank's market area further reduced the Company's dependence on agriculture.

In order to accommodate the demand of the Bank's customers for long-term residential real estate loans, a Real Estate Loan Office was opened in 1983. This office is centrally located in Davis, and has enabled the Bank to access the secondary real estate market.

The Vacaville Branch was opened in 1985. Vacaville is a rapidly growing community with a diverse economic base including a California state prison, food processing, distribution, shopping centers (Factory Outlet Stores), medical, biotech and other varied industries.

In 1994, the Fairfield Branch was opened. Fairfield has also been a rapidly growing community bounded by Vacaville to its east. Its diverse economic base includes military (Travis AFB), food processing (an Anheuser-Busch plant), retail (Solano Mall), manufacturing, medical, agriculture, and other varied industries. Fairfield is the county seat of Solano County.

A real estate loan production office was opened in El Dorado Hills, in April 1996, to serve the growing mortgage loan demand in the foothills area east of Sacramento. This office was moved to Folsom in 2006, a more central location for serving Folsom, Rancho Cordova, and the west slope of El Dorado County.

The SBA Loan Department was opened in April 1997 in Sacramento to serve the small business and industrial loan demand throughout the Bank's entire market area.

In June of 1997, the Bank's seventh branch was opened in Woodland, the county seat of Yolo County. Woodland is an expanding and diversified city with an economy dominated by agribusiness, retail services, and a healthy industrial sector.

The Bank's eighth branch, the Downtown Financial Center, opened in July of 2000 in Vacaville to serve the business and individual financial needs on the west side of Interstate-80. Also in July of 2000, in an adjacent office, the Bank opened its third real estate loan production office. The Vacaville real estate loan office was closed in 2007 in response to the current dramatic slowdown in the housing market. ecks es ofe I found. How does it look for including in our 10-K.
Two satellite banking offices of the Bank's Davis Branch were opened in 2001 in the Davis senior living communities of Covell Gardens and the University Retirement Community.

In December of 2001, Roseville became the site of the Bank's fourth real estate loan production office. This office serves the residential mortgage loan needs throughout Placer County.

In March of 2002, the Bank opened its ninth branch in a new class-A commercial building located on the harbor in Suisun City. After five years in operation and slower than anticipated city growth, in 2007 the Bank decided to close its Suisun City Branch and serve the Branch's customers out of its Fairfield Branch. The Fairfield Branch was expanded and remodeled to accommodate the additional customers and to include an investment & brokerage services office.

In October of 2002, the Bank opened its tenth branch on a prominent corner in Downtown Sacramento to serve Sacramento Metro's business center and its employees. The Bank's Asset Management & Trust Department, located on the mezzanine of the Downtown Sacramento Branch, was opened in 2002 to serve the trust and fiduciary needs of the Bank's entire market area. Fiduciary services are offered to individuals, businesses, governments and charitable organizations in the Solano, Yolo, Sacramento, Placer and El Dorado County regions.

In August of 2003, a full service real estate loan production office was opened in Woodland. This loan office is located within the same commercial office complex as the Bank's Woodland Branch. The Bank's history of servicing the Woodland community, coupled with the continued growth of the Woodland housing market, prompted this decision to expand the Bank's real estate loan services for the community. The economic recession of 2008, spurred on by falling real estate values, created the need to close the Woodland Real Estate Loan Office in July 2008. A real estate mortgage loan representative continues to serve the Woodland market.

The Bank expanded its presence in Placer County in January 2005 by opening a full service branch on a prominent corner in the rapidly growing business district of Roseville.

In the fourth quarter of 2006, the Bank opened its Folsom Financial Center which houses a full service branch, a real estate loan production office, and an investment & brokerage services office. Due to a slowdown in the economy and strong local competition for financial services, in June 2008, it was decided that the Bank's Folsom deposit and loan customers could be consolidated into the Bank's Roseville and Downtown Sacramento Branches. In October 2008, the Folsom Investment & Brokerage Services team moved out of the space it occupied within the former Folsom Branch to share a suite with the Folsom Real Estate Loan team just a couple of doors down the hall.

In late 2007, First Northern Bank seized an opportunity in Auburn to acquire several key personnel from a highly respected local bank that had just merged with a large conglomerate bank. While First Northern scouted for a branch site, the 'Auburn team' worked from the Bank's Roseville Branch to develop business in Auburn. In June 2008, the Bank opened its Auburn Financial Center in a temporary location within a busy retail shopping center along Highway 49. The Financial Center houses a full service branch and an Investment & Brokerage Services Office. Auburn is the county seat of Placer County.

Through this period of change and diversification, the Bank's strategic focus, which emphasizes serving the banking needs of individuals and small-to medium-sized businesses, has not changed. The Bank takes real estate, crop proceeds, securities, savings and time deposits, automobiles, and equipment as collateral for loans.

Most of the Bank's deposits are attracted from the market of northern and central Solano County and southern and central Yolo County. The Company believes that the Bank's deposit base does not involve any undue concentration levels from one or a few major depositors.

As of December 31, 2008, the Company and the Bank employed 228 full-time equivalent staff. The Company and the Bank consider their relationship with their employees to be good and have not experienced any interruptions of operations due to labor disagreements.

First Northern has historically experienced seasonal swings in both deposit and loan volumes due primarily to general economic factors and specific economic factors affecting our customers. Deposits have typically hit lows in February or March and have peaked in November or December. Loans typically peak in the late spring and hit lows in the fall as crops are harvested and sold. Since the real estate and agricultural economies generally follow the same seasonal cycle, they experience the same deposit and loan fluctuations.

Available Information

The Company’s internet address is www.thatsmybank.com, and the Company makes available free of charge on this website its Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports, as soon as reasonably practicable after the Company electronically files such material with, or furnishes it to, the SEC. These filings are also accessible on the SEC's website at www.sec.gov. The information found on the Company’s website shall not be deemed incorporated by reference by any general statement incorporating by reference this report into any filing under the Securities Act of 1933 or under the Securities Exchange Act of 1934 and shall not otherwise be deemed filed under such Acts.

The Effect of Government Policy on Banking

The earnings and growth of the Bank are affected not only by local market area factors and general economic conditions, but also by government monetary and fiscal policies. For example, the Board of Governors of the Federal Reserve System (the “FRB”) influences the supply of money through its open market operations in U.S. Government securities, adjustments to the discount rates applicable to borrowings by depository institutions and others and establishment of reserve requirements against both member and non-member financial institutions’ deposits. Such actions significantly affect the overall growth and distribution of loans, investments and deposits and also affect interest rates charged on loans and paid on deposits. The nature and impact of future changes in such policies on the business and earnings of the Company cannot be predicted. Additionally, state and federal tax policies can impact banking organizations.

As a consequence of the extensive regulation of commercial banking activities in the United States, the business of the Company is particularly susceptible to being affected by the enactment of federal and state legislation which may have the effect of increasing or decreasing the cost of doing business, modifying permissible activities or enhancing the competitive position of other financial institutions. Any change in applicable laws, regulations or policies may have a material adverse effect on the business, financial condition or results of operations, or prospects of the Company.

Regulation and Supervision of Bank Holding Companies

The Company is a bank holding company subject to the Bank Holding Company Act of 1956, as amended (the “BHCA”). The Company reports to, registers with, and may be examined by, the FRB. The FRB also has the authority to examine the Company’s subsidiaries. The costs of any examination by the FRB are payable by the Company.

The Company is a bank holding company within the meaning of Section 3700 of the California Financial Code. As such, the Company and the Bank are subject to examination by, and may be required to file reports with, the California Commissioner of Financial Institutions (the “Commissioner”).

The FRB has significant supervisory and regulatory authority over the Company and its affiliates. The FRB requires the Company to maintain certain levels of capital. See “Capital Standards” below for more information. The FRB also has the authority to take enforcement action against any bank holding company that commits any unsafe or unsound practice, or violates certain laws, regulations or conditions imposed in writing by the FRB. See “Prompt Corrective Action and Other Enforcement Mechanisms” below for more information. According to FRB policy, bank holding companies are expected to act as a source of financial and managerial strength to subsidiary banks, and to commit resources to support subsidiary banks. This support may be required at times when a bank holding company may not be able to provide such support.

Under the BHCA, a company generally must obtain the prior approval of the FRB before it exercises a controlling influence over a bank, or acquires, directly or indirectly, more than 5% of the voting shares or substantially all of the assets of any bank or bank holding company. Thus, the Company is required to obtain the prior approval of the FRB before it acquires, merges or consolidates with any bank or bank holding company. Any company seeking to acquire, merge or consolidate with the Company also would be required to obtain the prior approval of the FRB.

The Company is generally prohibited under the BHCA from acquiring ownership or control of more than 5% of the voting shares of any company that is not a bank or bank holding company and from engaging directly or indirectly in activities other than banking, managing banks, or providing services to affiliates of the holding company. However, a bank holding company, with the approval of the FRB, may engage, or acquire the voting shares of companies engaged, in activities that the FRB has determined to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. A bank holding company must demonstrate that the benefits to the public of the proposed activity will outweigh the possible adverse effects associated with such activity.

The Gramm-Leach-Bliley Act of 1999 ("GLBA") eliminated many of the restrictions placed on the activities of bank holding companies that become financial holding companies. Among other things, GLBA repealed certain Glass-Steagall Act restrictions on affiliations between banks and securities firms, and amended the BHCA to permit bank holding companies that are financial holding companies to engage in activities, and acquire companies engaged in activities, that are: financial in nature (including insurance underwriting, insurance company portfolio investment, financial advisor, securities underwriting, dealing and market-making, and merchant banking activities); incidental to financial activities; or complementary to financial activities if the FRB determines that they pose no substantial risk to the safety or soundness of depository institutions or the financial system in general. The Company has not become a financial holding company. GLBA also permits national banks to engage in activities considered financial in nature through a financial subsidiary, subject to certain conditions and limitations and with the approval of the Comptroller of the Currency.

A bank holding company may acquire banks in states other than its home state without regard to the permissibility of such acquisitions under state law, but subject to any state requirement that the bank has been organized and operating for a minimum period of time, not to exceed five years, and the requirement that the bank holding company, prior to or following the proposed acquisition, controls no more than 10% of the total amount of deposits of insured depository institutions in the United States and no more than 30% of such in that state (or such lesser or greater amount set by state law). Banks may also merge across state lines, thereby creating interstate branches. Furthermore, a bank is able to open new branches in a state in which it does not already have banking operations, if the laws of such state permit such de novo branching.

Under California law, (a) out-of-state banks that wish to establish a California branch office to conduct core banking business must first acquire an existing California bank or industrial bank, which has existed for at least five years, by merger or purchase, (b) California state-chartered banks are empowered to conduct various authorized branch-like activities on an agency basis through affiliated and unaffiliated insured depository institutions in California and other states, and (c) the Commissioner is authorized to approve an interstate acquisition or merger which would result in a deposit concentration in California exceeding 30% if the Commissioner finds that the transaction is consistent with public convenience and advantage. However, a state bank chartered in a state other than California may not enter California by purchasing a California branch office of a California bank or industrial bank without purchasing the entire entity or by establishing a de novo California bank.

The FRB generally prohibits a bank holding company from declaring or paying a cash dividend which would impose undue pressure on the capital of subsidiary banks or would be funded only through borrowing or other arrangements that might adversely affect a bank holding company's financial position. The FRB's policy is that a bank holding company should not continue its existing rate of cash dividends on its common stock unless its net income is sufficient to fully fund each dividend and its prospective rate of earnings retention appears consistent with its capital needs, asset quality and overall financial condition. The Company is also subject to restrictions relating to the payment of dividends under California corporate law. See "Restrictions on Dividends and Other Distributions" below for additional restrictions on the ability of the Company and the Bank to pay dividends.

Transactions between the Company and the Bank are subject to a number of other restrictions. FRB policies forbid the payment by bank subsidiaries of management fees, which are unreasonable in amount or exceed the fair market value of the services rendered (or, if no market exists, actual costs plus a reasonable profit). Subject to certain limitations, depository institution subsidiaries of bank holding companies may extend credit to, invest in the securities of, purchase assets from, or issue a guarantee, acceptance, or letter of credit on behalf of, an affiliate, provided that the aggregate of such transactions with affiliates may not exceed 10% of the capital stock and surplus of the institution, and the aggregate of such transactions with all affiliates may not exceed 20% of the capital stock and surplus of such institution. The Company may only borrow from depository institution subsidiaries of the Company if the loan is secured by marketable obligations with a value of a designated amount in excess of the loan. Further, the Company may not sell a low-quality asset to the Bank.

Bank Regulation and Supervision

The Bank is subject to regulation, supervision and regular examination by the California Department of Financial Institutions ("DFI") and the FDIC and the Company by the FRB. The regulations of these agencies affect most aspects of the Company's business and prescribe permissible types of loans and investments, the amount of required reserves, requirements for branch offices, the permissible scope of the Company's activities and various other requirements. While the Bank is not a member of the FRB, it is also directly subject to certain regulations of the FRB dealing primarily with check clearing activities, establishment of banking reserves, Truth-in-Lending (Regulation Z), Truth-in-Savings (Regulation DD), and Equal Credit Opportunity (Regulation B). In addition, the banking industry is subject to significantly increased regulatory controls and processes regarding Bank Secrecy Act and anti-money laundering laws. In recent years, a number of banks and bank holding companies announced the imposition of regulatory sanctions, including regulatory agreements and cease and desist orders and, in some cases, fines and penalties by the bank regulators due to failures to comply with the Bank Secrecy Act and other anti-money laundering legislation. In a number of these cases, the fines and penalties have been significant. Failure to comply with these additional requirements may also adversely affect the ability to obtain regulatory approvals for future initiatives requiring regulatory approval, including acquisitions.

Under California law, the Bank is subject to various restrictions on, and requirements regarding, its operations and administration including the maintenance of branch offices and automated teller machines, capital and reserve requirements, deposits and borrowings, stockholder rights and duties, and investment and lending activities.

California law permits a state chartered bank to invest in the stock and securities of other corporations, subject to a state chartered bank receiving either general authorization or, depending on the amount of the proposed investment, specific authorization from the Commissioner. Federal banking laws, however, impose limitations on the activities and equity investments of state chartered, federally insured banks. The FDIC rules on investments prohibit a state bank from acquiring an equity investment of a type, or in an amount, not permissible for a national bank. Non-permissible investments must have been divested by state banks no later than December 19, 1996. FDIC rules also prohibit a state bank from engaging as a principal in any activity that is not permissible for a national bank, unless the bank is adequately capitalized and the FDIC approves the activity after determining that such activity does not pose a significant risk to the deposit insurance fund. The FDIC rules on activities generally permit subsidiaries of banks, without prior specific FDIC authorization, to engage in those activities that have been approved by the FRB for bank holding companies because such activities are so closely related to banking to be a proper incident thereto. Other activities generally require specific FDIC prior approval and the FDIC may impose additional restrictions on such activities on a case-by-case basis in approving applications to engage in otherwise impermissible activities.

The USA Patriot Act

Title III of the United and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the "USA Patriot Act") includes numerous provisions for fighting international money laundering and blocking terrorism access to the U.S. financial system. The USA Patriot Act requires certain additional due diligence and record keeping practices, including, but not limited to, new customers, correspondent and private banking accounts. In March 2006, President Bush signed into law a renewal of the USA Patriot Act.

Part of the USA Patriot Act is the International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001 ("IMLAFATA"). Among its provisions, IMLAFATA requires each financial institution to: (i) establish an anti-money laundering program; (ii) establish appropriate anti-money laundering policies, procedures and controls; (iii) appoint a Bank Secrecy Act officer responsible for day-to-day compliance; and (iv) conduct independent audits. In addition, IMLAFATA contains a provision encouraging cooperation among financial institutions, regulatory authorities and law enforcement authorities with respect to individuals, entities and organizations engaged in, or reasonably suspected of engaging in, terrorist acts or money laundering activities. IMLAFATA expands the circumstances under which funds in a bank account may be forfeited and requires covered financial institutions to respond under certain circumstances to requests for information from federal banking agencies within 120 hours. IMLAFATA also amends the BHCA and the Bank Merger Act to require the federal banking agencies to consider the effectiveness of a financial institution's anti-money laundering activities when reviewing an application under these Acts.

Pursuant to IMLAFATA, the Secretary of the Treasury, in consultation with the heads of other government agencies, has adopted and proposed special measures applicable to banks, bank holding companies, and/or other financial institutions. These measures include enhanced record keeping and reporting requirements for certain financial transactions that are of primary money laundering concern, due diligence requirements concerning the beneficial ownership of certain types of accounts, and restrictions or prohibitions on certain types of accounts with foreign financial institutions.

Privacy Restrictions

GLBA, in addition to the previous described changes in permissible non-banking activities permitted to banks, bank holding companies and financial holding companies, also requires financial institutions in the U.S. to provide certain privacy disclosures to customers and consumers, to comply with certain restrictions on the sharing and usage of personally identifiable information, and to implement and maintain commercially reasonable customer information safeguarding standards.

The Company believes that it complies with all provisions of GLBA and all implementing regulations, and the Bank has developed appropriate policies and procedures to meet its responsibilities in connection with the privacy provisions of GLBA.

In October 2007, the federal bank regulatory agencies adopted final rules implementing the affiliate marketing provisions of the Fair and Accurate Credit Transactions Act of 2003, which amended the Fair Credit Reporting Act (FCRA). The final rules, which became effective on January 1, 2008, impose a prohibition, subject to certain exceptions, on a financial institution using certain information received from an affiliate to make a solicitation to a consumer unless the consumer is given notice and a reasonable opportunity to opt out of such solicitations, and the consumer does not opt out. The final rules apply to information obtained from the consumer's transactions or account relationships with an affiliate, any application the consumer submitted to an affiliate, and third-party sources, such as credit reports, if the information is to be used to send marketing solicitations. The rules do not supersede or affect a consumer's existing right under other provisions of the FCRA to opt out of the sharing between a financial institution and its affiliates of consumer information other than information relating solely to transactions or experiences between the consumer and the financial institution or its affiliates.

California and other state legislatures have adopted privacy laws, including laws prohibiting sharing of customer information without the customer's prior permission. These laws may make it more difficult for the Company to share information with its marketing partners, reduce the effectiveness of marketing programs, and increase the cost of marketing programs.

Capital Standards

The federal banking agencies have risk-based capital adequacy guidelines intended to provide a measure of capital adequacy that reflects the degree of risk associated with a banking organization's operations for both transactions reported on the balance sheet as assets and transactions, such as letters of credit, and recourse arrangements, which are recorded as off-balance-sheet items. Under these guidelines, nominal dollar amounts of assets and credit equivalent amounts of off-balance-sheet items are multiplied by one of several risk adjustment percentages, which range from 0% for assets with low credit risk, such as certain U.S. government securities, to 100% for assets with relatively higher credit risk, such as certain loans.

In determining the capital level the Bank is required to maintain, the federal banking agencies do not, in all respects, follow generally accepted accounting principles ("GAAP") and have special rules which have the effect of reducing the amount of capital that will be recognized for purposes of determining the capital adequacy of the Bank.

A banking organization's risk-based capital ratios are obtained by dividing its qualifying capital by its total risk-adjusted assets and off-balance-sheet items. The regulators measure risk-adjusted assets and off-balance-sheet items against both total qualifying capital (the sum of Tier 1 capital and limited amounts of Tier 2 capital) and Tier 1 capital. Tier 1 capital consists of common stock, retained earnings, non-cumulative perpetual preferred stock, trust preferred securities (for up to 25% of total tier 1 capital), other types of qualifying preferred stock and minority interests in certain subsidiaries, less most other intangible assets and other adjustments. Net unrealized losses on available-for-sale equity securities with readily determinable fair value must be deducted in determining Tier 1 capital. For Tier 1 capital purposes, deferred tax assets that can only be realized if an institution earns sufficient taxable income in the future are limited to the amount that the institution is expected to realize within one year, or 10% of Tier 1 capital, whichever is less. Tier 2 capital may consist of a limited amount of the allowance for possible loan and lease losses, term preferred stock and other types of preferred stock and trust preferred securities not qualifying as Tier 1 capital, term subordinated debt and certain other instruments with some characteristics of equity. The inclusion of elements of Tier 2 capital are subject to certain other requirements and limitations of the federal banking agencies. The federal banking agencies require a minimum ratio of qualifying total capital to risk-adjusted assets and off-balance-sheet items of 8%, and a minimum ratio of Tier 1 capital to adjusted average risk-adjusted assets and off-balance-sheet items of 4%.

Under FDIC regulations, there are also two rules governing minimum capital levels that FDIC-supervised banks must maintain against the risks to which they are exposed. The first rule makes risk-based capital standards consistent for two types of credit enhancements (i.e., recourse arrangements and direct credit substitutes) and requires different amounts of capital for different risk positions in asset securitization transactions. The second rule permits limited amounts of unrealized gains on debt and equity securities to be recognized for risk-based capital purposes as of September 1, 1998. The FDIC rules also provide that a qualifying institution that sells small business loans and leases with recourse must hold capital only against the amount of recourse retained. In general, a qualifying institution is one that is well capitalized under the FDIC's prompt corrective action rules. The amount of recourse that can receive the preferential capital treatment cannot exceed 15% of the institution's total risk-based capital.

Effective January 1, 2002, the federal banking agencies, including the FDIC, adopted new regulations to change their regulatory capital standards to address the treatment of recourse obligations, residual interests and direct credit substitutes in asset securitizations that expose banks primarily to credit risk. Capital requirements for positions in securitization transactions are varied according to their relative risk exposures, while limited use is permitted of credit ratings from rating agencies, a banking organization’s qualifying internal risk rating system or qualifying software. The regulation requires a bank to deduct from Tier 1 capital, and from assets, all credit-enhancing interest only-strips, whether retained or purchased that exceed 25% of Tier 1 capital. Additionally, a bank must maintain dollar-for-dollar risk-based capital for any remaining credit-enhancing interest-only strips and any residual interests that do not qualify for a ratings-based approach. The regulation specifically reserves the right to modify any risk-weight, credit conversion factor or credit equivalent amount, on a case-by-case basis, to take into account any novel transactions that do not fit well into the currently defined categories.

In addition to the risk-based guidelines, federal banking regulators require banking organizations to maintain a minimum amount of Tier 1 capital to adjusted average total assets, referred to as the leverage capital ratio. For a banking organization rated in the highest of the five categories used by regulators to rate banking organizations, the minimum lever–age ratio of Tier 1 capital to total assets must be 3%. It is improbable; however, that an institution with a 3% leverage ratio would receive the highest rating by the regulators since a strong capital position is a significant part of the regulators' rating. For all banking organizations not rated in the highest category, the minimum leverage ratio must be at least 100 to 200 basis points above the 3% minimum. Thus, the effective minimum leverage ratio, for all practical purposes, must be at least 4% or 5%. In addition to these uniform risk-based capital guidelines and leverage ratios that apply across the industry, the regulators have the discretion to set individual minimum capital requirements for specific institutions at rates significantly above the minimum guidelines and ratios.

As of December 31, 2008, the Company's and the Bank's capital ratios exceeded applicable regulatory requirements.

The following tables present the capital ratios for the Company and the Bank, compared to the standards for well-capitalized bank holding companies and depository institutions, as of December 31, 2008 (amounts in thousands except percentage amounts).

	The Company		
	Actual Capital	Ratio	Adequately Capitalized Ratio
Leverage	$ 58,760	8.8%	4.0%
Tier 1 Risk-Based	58,760	10.1%	4.0%
Total Risk-Based	66,107	11.4%	8.0%

	The Bank			
	Actual Capital	Ratio	Adequately Capitalized Ratio	Well Capitalized Ratio
Leverage	$ 58,377	8.7%	4.0%	5.0%
Tier 1 Risk-Based	58,377	10.1%	4.0%	6.0%
Total Risk-Based	65,724	11.3%	8.0%	10.0%

The federal banking agencies must take into consideration concentrations of credit risk and risks from non-traditional activities, as well as an institution's ability to manage those risks, when determining the adequacy of an institution's capital. This evaluation will be made as a part of the institution's regular safety and soundness examination. The federal banking agencies must also consider interest rate risk (when the interest rate sensitivity of an institution's assets does not match the sensitivity of its liabilities or its off-balance-sheet position) in evaluating a Bank's capital adequacy.

Prompt Corrective Action and Other Enforcement Mechanisms

The Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA") requires each federal banking agency to take prompt corrective action to resolve the problems of insured depository institutions, including but not limited to those that fall below one or more prescribed minimum capital ratios. The law required each federal banking agency to promulgate regulations defining the following five categories in which an insured depository institution will be placed, based on the level of its capital ratios: well capitalized, adequately capitalized, under–capitalized, significantly undercapitalized and critically undercapitalized.

Under the prompt corrective action provisions of FDICIA, an insured depository institution generally will be classified in the following categories based on the capital measures indicated below:

"Well capitalized"	"Adequately capitalized"
Total risk-based capital of 10%;	Total risk-based capital of 8%;
Tier 1 risk-based capital of 6%; and	Tier 1 risk-based capital of 4%; and
Leverage ratio of 5%.	Leverage ratio of 4%.

"Undercapitalized"	"Significantly undercapitalized"
Total risk-based capital less than 8%;	Total risk-based capital less than 6%;
Tier 1 risk-based capital less than 4%; or	Tier 1 risk-based capital less than 3%; or
Leverage ratio less than 4%.	Leverage ratio less than 3%.

"Critically undercapitalized"
Tangible equity to total assets less than 2%.

An institution that, based upon its capital levels, is classified as "well capitalized," "adequately capitalized" or "under–capitalized" may be treated as though it were in the next lower capital category if the appropriate federal banking agency, after notice and opportunity for hearing, determines that an unsafe or unsound condition or an unsafe or unsound practice warrants such treatment. At each successive lower capital category, an insured depository institution is subject to more restrictions. Management believes that at December 31, 2008, the Company and the Bank met the requirements for "well capitalized" institutions.

In addition to measures taken under the prompt corrective action provisions, commercial banking organizations may be subject to potential enforcement actions by the federal regulators for unsafe or unsound practices in conducting their businesses or for violations of any law, rule, regulation or any condition imposed in writing by the agency or any written agreement with the agency. Enforcement actions may include the imposition of a conservator or receiver, the issuance of a cease-and-desist order that can be judicially enforced, the termination of insurance of deposits (in the case of a depository institution), the imposition of civil money penalties, the issuance of directives to increase capital, the issuance of formal and informal agreements, the issuance of removal and prohibition orders against institution-affiliated parties and the enforcement of such actions through injunctions or restraining orders based upon a judicial determination that the agency would be harmed if such equitable relief was not granted. Additionally, a holding company's inability to serve as a source of strength to its subsidiary banking organizations could serve as an additional basis for a regulatory action against the holding company.

Safety and Soundness Standards

FDICIA also implemented certain specific restrictions on transactions and required federal banking regulators to adopt overall safety and soundness standards for depository institutions related to internal control, loan underwriting and documentation and asset growth. Among other things, FDICIA limits the interest rates paid on deposits by undercapitalized institutions, restricts the use of brokered deposits, limits the aggregate extensions of credit by a depository institution to an executive officer, director, principal shareholder or related interest, and reduces deposit insurance coverage for deposits offered by undercapitalized institutions for deposits by certain employee benefits accounts.

The federal banking agencies may require an institution to submit to an acceptable compliance plan as well as have the flexibility to pursue other more appropriate or effective courses of action given the specific circumstances and severity of an institution's non-compliance with one or more standards.

Restrictions on Dividends and Other Distributions

The power of the board of directors of an insured depository institution to declare a cash dividend or other distribution with respect to capital is subject to statutory and regulatory restrictions which limit the amount available for such distribution depending upon the earnings, financial condition and cash needs of the institution, as well as general business conditions. FDICIA prohibits insured depository institutions from paying management fees to any controlling persons or, with certain limited exceptions, making capital distributions, including dividends, if, after such transaction, the institution would be undercapitalized.

The federal banking agencies also have authority to prohibit a depository institution from engaging in business practices, which are considered to be unsafe or unsound, possibly including payment of dividends or other payments under certain circumstances even if such payments are not expressly prohibited by statute.

In addition to the restrictions imposed under federal law, banks chartered under California law generally may only pay cash dividends to the extent such payments do not exceed the lesser of retained earnings of the bank's net income for its last three fiscal years (less any distributions to shareholders during such period). In the event a bank desires to pay cash dividends in excess of such amount, the bank may pay a cash dividend with the prior approval of the Commissioner in an amount not exceeding the greatest of the bank's retained earnings, the bank's net income for its last fiscal year, or the bank's net income for its current fiscal year.

Premiums for Deposit Insurance

The Bank is a member of the Deposit Insurance Fund (DIF) maintained by the FDIC. Through the DIF, the FDIC insures the deposits of the Bank up to prescribed limits for each depositor. The DIF was formed March 31, 2006, upon the merger of the Bank Insurance Fund ("BIF') and the Savings Association Insurance Fund ("SAIF) in accordance with the Federal Deposit Insurance Reform Act of 2005. To maintain the DIF, member institutions are assessed an insurance premium based on their deposits and their institutional risk category. The FDIC determines an institution's risk category by combining its supervisory ratings with its financial ratios and other risk measures.

The Federal Deposit Insurance Reform Act of 2005, as implemented by the FDIC, adopted a new schedule of rates that the FDIC can adjust up or down, depending on the revenue needs of the insurance fund. To offset assessments, a member institution may apply certain one time credits, based on the institution's (or its successor's) assessment base as of the end of 1996. An institution may apply available credits up to 100% of assessments in 2007, and up to 90% of assessments in each of 2008, 2009 and 2010. Although an FDIC credit for prior contributions offset most of the assessment for 2007, the insurance assessments the Bank will pay has increased our costs starting in 2008. This new assessment system has resulted in annual assessments on deposits of the Bank of approximately $456,000. Any further increases in the deposit insurance assessments the Bank pays would further increase our costs.

The FDIC may terminate a depository institution's deposit insurance upon a finding that the institution's financial condition is unsafe or unsound or that the institution has engaged in unsafe or unsound practices or has violated any applicable rule, regulation, order or condition enacted or imposed by the institution's regulatory agency. The termination of deposit insurance for the Bank would have a material adverse effect on our business and prospects.

The Deposit Insurance Funds Act of 1996 (the "Deposit Funds Act") separated the Financing Corporation ("FICO") assessment to service the interest on FICO bond obligations from the BIF and SAIF assessments. The FICO annual assessment on individual depository institutions is in addition to the amount, if any, paid for deposit insurance according to the FDIC's risk-based assessment rate schedules. FICO assessment rates may be adjusted quarterly by the FDIC. The current FICO assessment rate is 1.14 cents per $100 of deposits. In addition, the FDIC has authority to impose special assessments from time to time, subject to certain limitations specified in the Deposit Funds Act.

The FDIC has recently determined that the reserve ratio for the DIF was 0.76 percent as of September 30, 2008 and 0.40 percent as of December 31, 2008 (preliminary), the lowest reserve ratio for the combined bank and thrift insurance fund since 1993. The FDIC is required to establish and implement a plan within 90 days to restore the reserve ratio to 1.15 percent within five years (subject to extension due to extraordinary circumstances). For the quarter beginning January 1, 2009, the FDIC has raised the base annual assessment rate for institutions in Risk Category I to between 12 and 14 basis points and in Risk Categories II, III and IV to 17, 35 and 50 basis points, respectively. An institution's assessment rate could be lowered by as much as two basis points based on the ratio of its long-term unsecured debt to deposits or, for smaller institutions, by the ratio of its Tier 1 capital in excess of 15 percent to deposits. The assessment rate would be adjusted towards the maximum rate for Risk Category I institutions that have a high level of brokered deposits or have experienced higher levels of asset growth (other than through acquisitions) and could be increased by as much as 10 basis points for institutions in Risk Categories II, III and IV whose ratio of brokered deposits to deposits exceeds 10 percent. An institution's base assessment rate would also be increased if an institution's ratio of secured liabilities (including Federal Home Loan Bank advances) to deposits exceeds 15 percent. The maximum adjustment for secured liabilities for institutions in Risk Categories I, II, III and IV would be 7, 10, 15 and 22.5 basis points, respectively. On February 27, 2009, the Board of Directors of the FDIC voted to amend the restoration plan for the Deposit Insurance Fund, adopt an interim rule (subject to comment) imposing an emergency special assessment on insured institutions of 20 basis points on June 30, 2009 (to be collected on September 30, 2009), implement changes to the risk-based assessment system, and set rates beginning the second quarter of 2009. The FDIC extended the restoration plan period to seven years, concluding that the problems facing the financial services sector and the economy at large constitute extraordinary circumstances permitting such extension. The interim rule would also permit the FDIC to impose an emergency special assessment after June 30, 2009, of up to 10 basis points if necessary to maintain public confidence in federal deposit insurance or if the reserve ratio of the Deposit Insurance Fund falls to a level which shall be zero or close to negative at the end of a calendar quarter.

The amended restoration plan was accompanied by a final rule that sets assessment rates and makes adjustments designed to improve how the assessment system differentiates for risk. Under the final rule, banks in Risk Category I will pay initial base assessment rates ranging from 12 to 16 basis points on an annual basis, beginning on April 1, 2009, while the base annual assessment rates for institutions in Risk Categories II, III and IV will be adjusted to 22, 32 and 45 basis points, respectively. The final rule provides incentives in the form of a reduction in assessment rates for institutions that hold long-term unsecured debt and provides for increases in the base assessment rates for institutions that rely significantly on brokered deposits or secured liabilities. In addition, to the extent that assessments of participants in the Temporary Liquidity Guarantee Program (described in "Government Responses to Recent Economic Crisis" below) are insufficient to cover the expenses or losses arising from the Temporary Liquidity Guarantee Program, the FDIC may impose one or more emergency special assessments on all FDIC-insured depository institutions. Each such special assessment will be computed with reference to the amount by which an insured depository institution's average total assets exceed the sum of the institution's average total tangible equity and average total subordinated debt.

Community Reinvestment Act and Fair Lending

The Bank is subject to certain fair lending requirements and reporting obligations involving home mortgage lending operations and Community Reinvestment Act ("CRA") activities. The CRA generally requires the federal banking agencies to evaluate the record of a financial institution in meeting the credit needs of the Bank's local communities, including low- and moderate-income neighborhoods. In addition to substantive penalties and corrective measures that may be required for a violation of certain fair lending laws, the federal banking agencies may take compliance with such laws and CRA into account when regulating and supervising other activities, particularly applications involving business expansion such as acquisitions or de novo branching.

Sarbanes – Oxley Act

On July 30, 2002, President Bush signed into law The Sarbanes-Oxley Act of 2002. This legislation addressed accounting oversight and corporate governance matters among public companies, including:

- the creation of a five-member oversight board that sets standards for accountants and has investigative and disciplinary powers;
- the prohibition of accounting firms from providing various types of consulting services to public clients and requires accounting firms to rotate partners among public client assignments every five years;
- increased penalties for financial crimes;
- expanded disclosure of corporate operations and internal controls and certification of financial statements;
- enhanced controls on, and reporting of, insider trading; and
- prohibition on lending to officers and directors of public companies, although the Bank may continue to make these loans within the constraints of existing banking regulations.

Among other provisions, Section 302(a) of the Sarbanes-Oxley Act requires that our Chief Executive Officer and Chief Financial Officer certify that our quarterly and annual reports do not contain any untrue statement or omission of a material fact. Specific requirements of the certifications include having these officers confirm that they are responsible for establishing, maintaining and regularly evaluating the effectiveness of our disclosure controls and procedures; they have made certain disclosures to our auditors and Audit Committee about our internal controls; and they have included information in our quarterly and annual reports about their evaluation and whether there have been significant changes in our internal controls or in other factors that could significantly affect internal controls subsequent to their evaluation.

In addition, Section 404 of the Sarbanes-Oxley Act and the SEC's rules and regulations thereunder require our management to evaluate, with the participation of our principal executive and principal financial officers, the effectiveness, as of the end of each fiscal year, of our internal control over financial reporting. Our management must then provide a report of management on our internal control over financial reporting that contains, among other things, a statement of their responsibility for establishing and maintaining adequate internal control over financial reporting, and a statement identifying the framework they used to evaluate the effectiveness of our internal control over financial reporting.

Government Responses to Recent Economic Crisis

The current economic crisis has negatively affected the U.S. and international financial markets. The magnitude of this financial crisis has prompted a variety of actions by the U.S. Government to respond to the challenges presented by these economic and financial developments.

The Emergency Economic Stabilization Act of 2008 (the EESA) which was enacted on October 3, 2008, is a response to the recent financial crises affecting the banking system and financial markets and going concern threats to investment banks and other financial institutions. Pursuant to the EESA, the maximum deposit insurance amount was temporarily increased from $100,000 to $250,000 per depositor through December 31, 2009. On October 14, 2008, the FDIC announced the establishment of a Temporary Liquidity Guarantee Program under which the FDIC will fully guarantee until December 31, 2009, all non-interest-bearing transaction accounts of insured depository institutions that do not opt out of the program by December 5, 2008. Pursuant to the Temporary Liquidity Guarantee Program, the FDIC will also guarantee newly issued senior unsecured debt of participating financial institutions and their qualifying holding companies. Institutions which participate in the Temporary Liquidity Guarantee Program are assessed at the rate of ten basis points for transaction account balances in excess of $250,000 and at the rate, on an annualized basis, of 50 to 100 basis points of the amount of debt issued (on a sliding scale, depending on length of maturity of the debt).

As a part of EESA, the U.S. Treasury has enacted a voluntary Capital Purchase Program under its Troubled Asset Relief Program (TARP) pursuant to which the Treasury will purchase up to $250 billion in senior preferred stock of qualifying U.S. financial institutions. The nine largest banks in the U.S. initially agreed to participate in this program, with the U.S. Treasury purchasing an aggregate of $125 billion in senior preferred stock in such banks and allocating an additional $125 billion in senior preferred stock in other banking institutions. The purpose of the program is to provide substantial new capital to the U.S. banking industry. Many banks and bank holding companies have participated in such program. On January 15, 2009, the Senate voted to approve the release of an additional $350 billion in TARP funds. On March 13, 2009, pursuant to TARP, we sold approximately $17.4 million in preferred shares to the Treasury. See “Recent Events” below for additional information.

In February 2009, the Treasury outlined the “Financial Stability Plan: Deploying our Full Arsenal to Attack the Credit Crisis on All Fronts.” The Financial Stability Plan includes a wide variety of measures intended to address the domestic and global financial crisis and deterioration of credit markets. Many aspects of the Financial Stability Plan are conceptual in nature and contemplate future specific regulations and further regulatory and legislative enactment. Some of the key aspects of the Financial Stability Plan include:

- requiring banking institutions with assets in excess of $100 billion to undergo a forward-looking comprehensive “stress test” and providing such institutions with access to a U.S. Treasury-provided “capital buffer” to help absorb losses if the results of the test indicate that additional capital is needed and it cannot be obtained in the private sector;

- instituting a public-private investment fund which will be designed to involve both public and private capital and public financing for the acquisition of troubled and illiquid assets in the banking sector;

- substantial expenditures to support government-sponsored enterprises in the housing sector and a commitment of funds to help prevent avoidable foreclosures of owner-occupied residential real estate;

- a consumer and business lending initiative intended to support the purchase of loans by providing financing to private investors to help unfreeze and lower interest rates for auto, small business, credit card and other consumer and business credit;

- increased transparency and disclosure of exposure on bank balance sheets;

- various corporate governance and executive compensation regulations, including requiring “say on pay” proposals for institutions receiving funds.

As we have less than $100 billion in assets we do not believe that the stress test and U.S. Treasury-provided capital program will be applicable to the Bank.

On February 17, 2009 President Obama signed into law the American Recovery and Reinvestment Act of 2009 (ARRA) in an attempt to reverse the recent U.S. economic downturn. A large portion of the ARRA is devoted to new federal spending programs designed to increase economic output, decrease unemployment and invest in national infrastructure. Of the $787 billion in federal spending appropriated by the ARRA, $286 billion will be devoted to tax cuts, $120 billion will be used to fund infrastructure projects and $381 billion will be allocated for social programs and other spending. While ARRA is not directly aimed at regulating the financial services industry, it is possible that this level of federal spending could indirectly impact the financial services industry.

Pending Legislation and Regulations

In addition to the recent legislation discussed above, proposals to change the laws, regulations and policies impacting the banking and financial services industry are frequently introduced in Congress, in the state legislatures and before the various bank regulatory agencies. If enacted, such legislation could significantly change the competitive environment in which the Company operates. The likelihood and timing of any such changes and the impact such changes might have on the competitive situation, financial condition or results of operations of the Company cannot be predicted.

Competition

In the past, an independent bank's principal competitors for deposits and loans have been other banks (particularly major banks), savings and loan associations and credit unions. For agricultural loans, the Bank also competes with constituent entities with the Federal Farm Credit System. To a lesser extent, competition was also provided by thrift and loans, mortgage brokerage companies and insurance companies. Other institutions, such as brokerage houses, mutual fund companies, credit card companies, and even retail establishments have offered new investment vehicles, which also compete with banks for deposit business. The direction of federal legislation in recent years seems to favor competition among different types of financial institutions and to foster new entrants into the financial services market.

The enactment of GLBA is the latest evidence of this trend, and it is anticipated that this trend will continue as financial services institutions combine to take advantage of the elimination of the barriers against such affiliations. The enactment of the federal Interstate Banking and Branching Act in 1994 and the California Interstate Banking and Branching Act of 1995 have increased competition within California. Recent legislation has also made it easier for out-of-state credit unions to conduct business in California and allows industrial banks to offer consumers more lending products. Moreover, regulatory reform, as well as other changes in federal and California law will also affect competition. The availability of banking services over the Internet or "e-banking" has continued to expand. While the impact of these changes, and of other proposed changes, cannot be predicted with certainty, it is clear that the business of banking in California will remain highly competitive.

We also compete for deposits and loans with much larger financial institutions. Competition in our industry is likely to further intensify as a result of recent adverse economic and financial market conditions which has led to increased consolidation of financial services companies, including large consolidations of significance in our market area (such as JPMorgan Chase's acquisition of Washington Mutual and Wells Fargo Bank's acquisition of Wachovia Bank). In order to compete with major financial institutions and other competitors in its primary service areas, the Bank relies upon the experience of its executive and senior officers in serving business clients, and upon its specialized services, local promotional activities and the personal contacts made by its officers, directors and employees.

For customers whose loan demand exceeds the Bank's legal lending limit, the Bank may arrange for such loans on a participation basis with correspondent banks. The seasonal swings discussed earlier have, in the past, had some impact on the Bank's liquidity. The management of investment maturities, sale of loan participations, federal fund borrowings, qualification for funds under the Federal Reserve Bank's seasonal credit program, and the ability to sell mortgages in the secondary market is intended to allow the Bank to satisfactorily manage its liquidity.

Recent Events

On February 26, 2009, at a Special Meeting of Shareholders, our shareholders approved amendments to our Articles of Incorporation necessary to allow us to participate in the Treasury's TARP Capital Purchase Program. Specifically, these amendments authorized our Board of Directors to issue shares of preferred stock to the Treasury and created an exemption to the preemptive rights provision of our Articles of Incorporation with respect to the TARP financing.

On March 13, 2009 (the "Closing Date"), we issued and sold, and the Treasury purchased, (1) 17,390 shares (the "Preferred Shares") of the Company's Fixed Rate Cumulative Perpetual Preferred Stock, Series A, liquidation preference of $1,000 per share, and (2) a ten-year warrant (the "Warrant") to purchase up to 352,977 shares of the Company's common stock, without par value ("Common Stock"), at an exercise price of $7.39 per share, for an aggregate purchase price of $17.39 million in cash.

The securities were sold in a private placement exempt from registration pursuant to Section 4(2) of the Securities Act of 1933.

Cumulative dividends on the Preferred Shares will accrue on the liquidation preference at a rate of 5% per annum for the first five years, and at a rate of 9% per annum thereafter, if, as and when declared by the Company's Board of Directors out of funds legally available therefore. The Preferred Shares have no maturity date and rank senior to the Common Stock with respect to the payment of dividends and distributions and amounts payable upon liquidation, dissolution and winding up of the Company. Subject to the approval of the Board of Governors of the Federal Reserve System, the Preferred Shares are redeemable at the option of the Company at any time at 100% of their liquidation preference.

The Treasury may not transfer a portion or portions of the Warrant with respect to, and/or exercise the Warrant for more than one-half of, the 352,977 shares of Common Stock issuable upon exercise of the Warrant, in the aggregate, until the earlier of (i) the date on which the Company has redeemed the Preferred Shares and (ii) December 31, 2009. In the event the Company redeems the Preferred Shares pursuant to the terms of the TARP Capital Purchase Program prior to December 31, 2009, the number of the shares of Common Stock underlying the portion of the Warrant then held by the Treasury will be reduced by one-half of the shares of Common Stock originally covered by the Warrant.

The Purchase Agreement pursuant to which the Preferred Shares and the Warrant were sold contains limitations on the payment of dividends on the Common Stock, including with respect to the payment of cash dividends (but does not affect our ability to declare and pay stock dividends) and on the Company's ability to repurchase its Common Stock, and subjects the Company to certain of the executive compensation limitations included in EESA. As a condition to the closing of the transaction, each of Ownen J. Onsum, Louise A. Walker, Patrick S. Day and Robert M. Walker, the Company's Senior Executive Officers (as defined in the Purchase Agreement) (the "Senior Executive Officers"), executed a waiver (the "Waiver") voluntarily waiving any claim against the Treasury or the Company for any changes to such Senior Executive Officer's compensation or benefits that are required to comply with the regulation issued by the Treasury under the TARP Capital Purchase Program as published in the Federal Register on October 20, 2008 and acknowledging that the regulation may require modification of the compensation, bonus, incentive and other benefit plans, arrangements and policies and agreements (including so-called "golden parachute" agreements) (collectively, "Benefit Plans") as they relate to the period the Treasury holds any equity or debt securities of the Company acquired through the TARP Capital Purchase Program.

ITEM 1A – RISK FACTORS

In addition to factors mentioned elsewhere in this Report, the factors contained below, among others, could cause our financial condition and results of operations to be materially and adversely affected. If this were to happen, the value of our common stock could decline, perhaps significantly, and you could lose all or part of your investment.

The U.S Economy Has Experienced a Slowing of Economic Growth, Volatility in the Financial Markets, and Significant Deterioration in Sectors of the U.S. Residential Real Estate Markets, All of Which Present Challenges for the Banking and Financial Services Industry and for the Bank

Commencing in 2007 and continuing through 2009, certain adverse financial developments have impacted the U.S. economy and financial markets and present challenges for the banking and financial services industry and for the Bank. These developments include a general slowing of economic growth in the U.S. which has prompted the Congress to adopt an economic stimulus bill which President Bush signed into law on February 13, 2008, and which prompted the Federal Reserve Board to decrease its discount rate and the federal funds rate several times in the first quarter of 2008. These developments have contributed to substantial volatility in the equity securities markets, as well as volatility and a tightening of liquidity in the credit markets. In addition, financial and credit conditions in the domestic residential real estate markets have deteriorated significantly, particularly in the subprime sector. These conditions in turn have led to significant deterioration in certain financial markets, particularly the markets for subprime residential mortgage-backed securities and for collateralized debt obligations backed by residential mortgage-backed securities. The magnitude of this financial crisis has prompted a variety of actions by the U.S. Government to respond to the challenges presented by these economic and financial developments. These recent actions are discussed in Part I under the caption "Business—Government Responses to Recent Economic Crisis." This financial crisis presents significant challenges for the U.S. banking and financial services industry and for the Bank. While it is difficult to predict how long these conditions will exist and how and the extent to which the Bank may be affected, these factors will continue to present risks for some time for the industry and the Bank's financial condition, results of operations, cash flows and business prospects.

The Bank is Subject to Lending Risks of Loss and Repayment Associated with Commercial Banking Activities

The Bank's business strategy is to focus on commercial business loans (which includes agricultural loans), construction loans and commercial and multi-family real estate loans. The principal factors affecting the Bank's risk of loss in connection with commercial business loans include the borrower's ability to manage its business affairs and cash flows, general economic conditions and, with respect to agricultural loans, weather and climate conditions. Loans secured by commercial real estate are generally larger and involve a greater degree of credit and transaction risk than residential mortgage (one to four family) loans. Because payments on loans secured by commercial and multi-family real estate properties are often dependent on successful operation or management of the underlying properties, repayment of such loans may be dependent on factors other than the prevailing conditions in the real estate market or the economy. Real estate construction financing is generally considered to involve a higher degree of credit risk than long-term financing on improved, owner-occupied real estate. Risk of loss on a construction loan is dependent largely upon the accuracy of the initial estimate of the property's value at completion of construction or development compared to the estimated cost (including interest) of construction. If the estimate of value proves to be inaccurate, the Bank may be confronted with a project which, when completed, has a value which is insufficient to assure full repayment of the construction loan.

Although the Bank manages lending risks through its underwriting and credit administration policies, no assurance can be given that such risks will not materialize, in which event, the Company's financial condition, results of operations, cash flows and business prospects could be materially adversely affected.

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The Bank's Dependence on Real Estate Lending Increases Our Risk of Losses

At December 31, 2008, approximately 70% of the Bank's loans (excluding loans held-for-sale) were secured by real estate. The value of the Bank's real estate collateral has been, and could in the future continue to be, adversely affected by the economic recession and resulting adverse impact on the real estate market in Northern California. See "The U.S. Economy Has Experienced a Slowing of Economic Growth, Volatility in the Financial Markets and Significant Deterioration in Sectors of the U.S. Residential Real Estate Markets, All of Which Present Challenges for the Banking and Financial Services Industry and for the Bank" above, and "Adverse California Economic Conditions Could Adversely Affect the Bank's Business" below.

The Bank's primary lending focus has historically been commercial (including agricultural), construction and real estate mortgage. At December 31, 2008, real estate mortgage (excluding loans held-for-sale) and construction loans comprised approximately 57% and 13%, respectively, of the total loans in the Bank's portfolio. At December 31, 2008, all of the Bank's real estate mortgage and construction loans and approximately 9% of its commercial loans were secured fully or in part by deeds of trust on underlying real estate. The Company's dependence on real estate increases the risk of loss in both the Bank's loan portfolio and its holdings of other real estate owned if economic conditions in Northern California further deteriorate in the future. Further deterioration of the real estate market in Northern California would have a material adverse effect on the Company's business, financial condition and results of operations. See "Adverse California Economic Conditions Could Adversely Affect the Bank's Business" below.

Adverse California Economic Conditions Could Adversely Affect the Bank's Business

The Bank's operations and a substantial majority of the Bank's assets and deposits are generated and concentrated primarily in Northern California, particularly the counties of Placer, Sacramento, Solano and Yolo, and are likely to remain so for the foreseeable future. At December 31, 2008, approximately 70% of the Bank's loan portfolio (excluding loans held-for-sale) consisted of real estate-related loans, all of which were secured by collateral located in Northern California. As a result, a further downturn in the economic conditions in Northern California may cause the Bank to incur losses associated with high default rates and decreased collateral values in its loan portfolio. Economic conditions in California are subject to various uncertainties at this time, including the significant deterioration in the California real estate market and housing industry. Under the budget plan approved by the California Legislature and signed by Governor Arnold Schwarzenegger on February 20, 2009, the State of California will reduce services, increase sales and income taxes and other fees and take other expense reduction measures. In addition, California will fund a portion of the deficit through additional borrowings, which may include Revenue Anticipation Warrants, a relatively high-cost form of financing. Further, the budget requires California voter approval of ballot measures during a special election to be held on May 19, 2009. The measures would set a cap on state spending and institute a "rainy day" fund for periods of fiscal difficulty for the State's budget, authorize the State to sell bonds based on future lottery revenue, shift money from certain social programs, guarantee additional funds for schools and freeze lawmakers' pay when the State runs a deficit. Rejection of any of the revenue-related ballot measures would likely result in budget deficits which would need to be addressed later in 2009. The financial and economic consequences of this situation cannot be predicted with any certainty at this time. If economic conditions in California decline further it is expected that the Bank's level of problem assets would increase. California real estate is also subject to certain natural disasters, such as earthquakes, floods and mudslides, which are typically not covered by the standard hazard insurance policies maintained by borrowers. Uninsured disasters may make it difficult or impossible for borrowers to repay loans made by the Bank. The occurrence of natural disasters in California could have a material adverse effect on the Company's financial condition, results of operations, cash flows and business prospects.

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The Bank is Subject to Interest Rate Risk

The income of the Bank depends to a great extent on “interest rate differentials” and the resulting net interest margins (i.e., the difference between the interest rates earned on the Bank’s interest-earning assets such as loans and investment securities, and the interest rates paid on the Bank’s interest-bearing liabilities such as deposits and borrowings). These rates are highly sensitive to many factors, which are beyond the Bank’s control, including, but not limited to, general economic conditions and the policies of various governmental and regulatory agencies, in particular, the FRB. The Bank is generally adversely affected by declining interest rates. Changes in the relationship between short-term and long-term market interest rates or between different interest rate indices can also impact our interest rate differential, possibly resulting in a decrease in our interest income relative to interest expense. In addition, changes in monetary policy, including changes in interest rates, influence the origination of loans, the purchase of investments and the generation of deposits and affect the rates received on loans and investment securities and paid on deposits, which could have a material adverse effect on the Company’s business, financial condition and results of operations. See “Quantitative and Qualitative Disclosures About Market Risk” below.

Potential Volatility of Deposits May Increase Our Cost of Funds

At December 31, 2008, 10% of the dollar value of the Company’s total deposits was represented by time certificates of deposit in excess of $100,000. These deposits are considered volatile and could be subject to withdrawal. Withdrawal of a material amount of such deposits would adversely impact the Company’s liquidity, profitability, business prospects, results of operations and cash flows.

Our Ability to Pay Dividends is Subject to Legal Restrictions

As a bank holding company, our cash flow typically comes from dividends of the Bank. Various statutory and regulatory provisions restrict the amount of dividends the Bank can pay to the Company without regulatory approval. The ability of the Company to pay cash dividends in the future also depends on the Company’s profitability, growth and capital needs. In addition, California law restricts the ability of the Company to pay dividends. No assurance can be given that the Company will pay any dividends in the future or, if paid, such dividends will not be discontinued. See “Business - Restrictions on Dividends and Other Distributions” above.

Competition Adversely Affects our Profitability

In California generally, and in the Bank’s primary market area specifically, major banks dominate the commercial banking industry. By virtue of their larger capital bases, such institutions have substantially greater lending limits than those of the Bank. Competition is likely to further intensify as a result of recent adverse economic and financial market conditions which has led to increased consolidation of financial services companies, including large consolidations of significance in our market area (such as JPMorgan Chase’s acquisition of Washington Mutual and Wells Fargo Bank’s acquisition of Wachovia Bank). In obtaining deposits and making loans, the Bank competes with these larger commercial banks and other financial institutions, such as savings and loan associations, credit unions and member institutions of the Farm Credit System, which offer many services that traditionally were offered only by banks. Using the financial holding company structure, insurance companies and securities firms may compete more directly with banks and bank holding companies. In addition, the Bank competes with other institutions such as mutual fund companies, brokerage firms, and even retail stores seeking to penetrate the financial services market. Also, technology and other changes increasingly allow parties to complete financial transactions electronically, and in many cases, without banks. For example, consumers can pay bills and transfer funds over the internet and by telephone without banks. Non-bank financial service providers may have lower overhead costs and are subject to fewer regulatory constraints. If consumers do not use banks to complete their financial transactions, we could potentially lose fee income, deposits and income generated from those deposits. During periods of declining interest rates, competitors with lower costs of capital may solicit the Bank's customers to refinance their loans. Furthermore, during periods of economic slowdown or recession, the Bank's borrowers may face financial difficulties and be more receptive to offers from the Bank's competitors to refinance their loans. No assurance can be given that the Bank will be able to compete with these lenders. See "Business - Competition" above.

Government Regulation and Legislation Could Adversely Affect Us

The Company and the Bank are subject to extensive state and federal regulation, supervision and legislation, which govern almost all aspects of the operations of the Company and the Bank. The business of the Bank is particularly susceptible to being affected by the enactment of federal and state legislation, which may have the effect of increasing the cost of doing business, modifying permissible activities or enhancing the competitive position of other financial institutions. Such laws are subject to change from time to time and are primarily intended for the protection of consumers, depositors and the deposit insurance fund and not for the benefit of shareholders of the Company. Regulatory authorities may also change their interpretation of these laws and regulations. The Company cannot predict what effect any presently contemplated or future changes in the laws or regulations or their interpretations would have on the business and prospects of the Company, but it could be material and adverse. See "Bank Regulation and Supervision" above.

We maintain systems and procedures designed to comply with applicable laws and regulations. However, some legal/regulatory frameworks provide for the imposition of criminal or civil penalties (which can be substantial) for noncompliance. In some cases, liability may attach even if the noncompliance was inadvertent or unintentional and even if compliance systems and procedures were in place at the time. There may be other negative consequences from a finding of noncompliance, including restrictions on certain activities and damage to the Company's reputation.

Our Controls and Procedures May Fail or be Circumvented

The Company maintains controls and procedures to mitigate against risks such as processing system failures and errors, and customer or employee fraud, and maintains insurance coverage for certain of these risks. Any system of controls and procedures, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Events could occur which are not prevented or detected by the Company's internal controls or are not insured against or are in excess of the Company's insurance limits. Any failure or circumvention of the Company's controls and procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect on the Company's business, results of operations and financial condition.

Recent Changes in Deposit Insurance Premiums Could Adversely Affect Our Business

In 2006, the FDIC created a new assessment system designed to more closely tie what banks pay for deposit insurance to the risks they pose and adopted a new base schedule of rates that the FDIC can adjust up or down depending on the revenue needs of the insurance fund. Although an FDIC credit for prior contributions offset most of the assessment for 2007, the insurance assessments the Bank will pay has increased our costs starting in 2008. This new assessment system has resulted in annual assessments on deposits of the Bank of approximately $456,000. In addition, as discussed above in Part I under the caption "Business—Premiums for Deposit Insurance," the FDIC has taken recent steps which could further increase deposit premiums and is contemplating further increases and a special assessment. Any further increases in the deposit insurance assessments the Bank pays would further increase our costs.

Negative Public Opinion Could Damage Our Reputation and Adversely Affect Our Earnings

Reputational risk, or the risk to our earnings and capital from negative public opinion, is inherent in our business. Negative public opinion can result from the actual or perceived manner in which we conduct our business activities, management of actual or potential conflicts of interest and ethical issues and our protection of confidential client information. Negative public opinion can adversely affect our ability to keep and attract customers and employees and can expose us to litigation and regulatory action. We take steps to minimize reputation risk in the way we conduct our business activities and deal with our clients and communities.

Our Business Could Suffer if We Fail to Attract and Retain Skilled Personnel

The Company's future success depends to a significant extent on the efforts and abilities of our executive officers. The loss of the services of certain of these individuals, or the failure of the Company to attract and retain other qualified personnel, could have a material adverse effect on the Company's business, financial condition and results of operations.

The Continuing War on Terrorism Could Adversely Affect U.S. and Global Economic Conditions

Acts or threats of terrorism and actions taken by the U.S. or other governments as a result of such acts or threats and other international hostilities may result in a disruption of U.S. economic and financial conditions and could adversely affect business, economic and financial conditions in the U.S. generally and in our principal markets. The war in Iraq has also generated various political and economic uncertainties affecting the global and U.S. economies.

Changes in Accounting Standards Could Materially Impact Our Financial Statements

The Company's financial statements are presented in accordance with accounting principles generally accepted in the United States of America ("US GAAP"). The financial information contained within our financial statements is, to a significant extent, financial information that is based on approximate measures of the financial effects of transactions and events that have already occurred. A variety of factors could affect the ultimate value that is obtained either when earning income, recognizing an expense, recovering an asset or relieving a liability. Along with other factors, we use historical loss factors to determine the inherent loss that may be present in our loan portfolio. Actual losses could differ significantly from the historical loss factors that we use. Other estimates that we use are fair value of our securities and expected useful lives of our depreciable assets. We have not entered into derivative contracts for our customers or for ourselves, which relate to interest rate, credit, equity, commodity, energy, or weather-related indices. US GAAP itself may change from one previously acceptable method to another method. Although the economics of our transactions would be the same, the timing of events that would impact our transactions could change. Accounting standards and interpretations currently affecting the Company and its subsidiaries may change at any time, and the Company's financial condition and results of operations may be adversely affected. In some cases, we could be required to apply a new or revised standard retroactively, resulting in our restating prior period financial statements.

Increases in the Allowance for Loan Losses Would Adversely Affect the Bank's Financial Condition and Results of Operations

The Bank's allowance for estimated losses on loans was approximately $14.4 million, or 2.71% of total loans, at December 31, 2008, compared to $10.9 million, or 2.13% of total loans, at December 31, 2007, and 101% of total non-performing loans at December 31, 2008, compared to 70% of total non-performing loans at December 31, 2007. Material future additions to the allowance for estimated losses on loans may be necessary if material adverse changes in economic conditions occur and the performance of the Bank's loan portfolio deteriorates. In addition, an allowance for losses on other real estate owned may also be required in order to reflect changes in the markets for real estate in which the Bank's other real estate owned is located and other factors which may result in adjustments which are necessary to ensure that the Bank's foreclosed assets are carried at the lower of cost or fair value, less estimated costs to dispose of the properties. Moreover, the FDIC and the DFI, as an integral part of their examination process, periodically review the Bank's allowance for estimated losses on loans and the carrying value of its assets. Increases in the provisions for estimated losses on loans and foreclosed assets would adversely affect the Bank's financial condition and results of operations. See "Management's Discussion and Analysis of Financial Condition and Results of Operations - Summary of Loan Loss Experience" below.

Future Sales of Shares of the Company's Common Stock Could Have a Material Adverse Effect on the Market Price of the Common Stock

As of December 31, 2008, the Company had 8,608,802 shares of Common Stock outstanding, all of which are eligible for sale in the public market without restriction. Future sales of substantial amounts of the Company's Common Stock, or the perception that such sales could occur, could have a material adverse effect on the market price of the Common

Stock. In addition, options to acquire up to 7.6% of the unissued authorized shares of Common Stock at exercise prices ranging from $3.80 to $24.70 have been issued to directors and employees of the Company, over the past nine (9) years, under the Company's 2000 and 2006 Stock Option Plans and Outside Directors 2000 and 2006 Non-statutory Stock Option Plans, and options to acquire up to an additional 10.5% of the unissued authorized shares of Common Stock are reserved for issuance under such plans. In addition, on March 13, 2009, as part of our TARP financing, we issued a ten-year warrant to the Treasury to purchase up to 352,977 shares of the Company's common stock, without par value, at an exercise price of $7.39 per share. No prediction can be made as to the effect, if any, that future sales of shares, or the availability of shares for future sale, will have on the market price of the Company's Common Stock. See "Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities" below.

There is a Limited Public Market for the Company’s Common Stock which May Make it Difficult for Shareholders to Dispose of Their Shares

The Company’s common stock is not listed on any exchange. However, trades may be reported on the OTC Bulletin Board under the symbol “FNRN”. The Company is aware that Howe Barnes Hoefer & Arnett, Stone & Youngberg, Wedbush Morgan Securities and Monroe Securities, Inc., all currently make a market in the Company’s common stock. Management is aware that there are also private transactions in the Company’s common stock. However, the limited trading market for the Company’s common stock may make it difficult for shareholders to dispose of their shares. Also, the price of the Company’s common stock may be affected by general market price movements as well as developments specifically related to the financial services sector, including interest rate movements, quarterly variations, or changes in financial estimates by securities analysts and a significant reduction in the price of the stock of another participant in the financial services industry, as well as the level of repurchases of Company stock by the Company pursuant to its stock repurchase program.

Advances and Changes in Technology, and the Company’s Ability to Adapt Its Technology, could Impact Its Ability to Compete and Its Business and Operations

Advances and changes in technology can significantly impact the business and operations of the Company. The Company faces many challenges including the increased demand for providing computer access to Company accounts and the systems to perform banking transactions electronically. The Company’s merchant processing services require the use of advanced computer hardware and software technology and rapidly changing customer and regulatory requirements. The Company’s ability to compete depends on its ability to continue to adapt its technology on a timely and cost-effective basis to meet these requirements. In addition, the Company’s business and operations are susceptible to negative impacts from computer system failures, communication and energy disruption and unethical individuals with the technological ability to cause disruptions or failures of the Company’s data processing systems.

Environmental Hazards Could Have a Material Adverse Effect on the Company’s Business, Financial Condition and Results of Operations

The Company, in its ordinary course of business, acquires real property securing loans that are in default, and there is a risk that hazardous substances or waste, contaminants or pollutants could exist on such properties. The Company may be required to remove or remediate such substances from the affected properties at its expense, and the cost of such removal or remediation may substantially exceed the value of the affected properties or the loans secured by such properties. Furthermore, the Company may not have adequate remedies against the prior owners or other responsible parties to recover its costs. Finally, the Company may find it difficult or impossible to sell the affected properties either prior to or following any such removal. In addition, the Company may be considered liable for environmental liabilities in connection with its borrowers' properties, if, among other things, it participates in the management of its borrowers' operations. The occurrence of such an event could have a material adverse effect on the Company’s business, financial condition, results of operations and cash flows.

Shareholders of the Company Will Experience Dilution if Outstanding Options and Warrants are Exercised

As of December 31, 2008, the Company had outstanding options to purchase an aggregate of 564,145 shares of Common Stock at exercise prices ranging from $3.80 to $24.70 per share, or a weighted average exercise price per share of $10.55. In addition, on March 13, 2009, as part of our TARP financing, we issued a ten-year warrant to the Treasury to purchase up to 352,977 shares of the Company’s common stock, without par value, at an exercise price of $7.39 per share. It has been Treasury’s past practice to exercise TARP warrants shortly after closing the TARP financing. To the extent such options and warrants are exercised, shareholders of the Company will experience dilution. See “Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity

Securities" below.

ITEM 1B – UNRESOLVED STAFF COMMENTS

None.

ITEM 2 – PROPERTIES

The Company and the Bank are engaged in the banking business through 16 offices in five counties in Northern California operating out of four offices in Solano County, eight in Yolo County, two in Sacramento County and two in Placer County. In addition, the Company owns four vacant lots, three in northern Solano County and one in eastern Sacramento County, for possible future bank sites. The Company and the Bank believe all of their offices are constructed and e quipped to meet prescribed security requirements.

The Bank owns three branch office locations and two administrative facilities and leases 13 facilities. Most of the leases contain multiple renewal options and provisions for rental increases, principally for changes in the cost of living index, property taxes and maintenance.

ITEM 3 - LEGAL PROCEEDINGS

Neither the Company nor the Bank is a party to any material pending legal proceeding, nor is any of their property the subject of any material pending legal proceeding, except ordinary routine litigation arising in the ordinary course of the Bank's business and incidental to its business, none of which is expected to have a material adverse impact upon the Company's or the Bank's business, financial position or results of operations.

PART II

ITEM 5 - MARKET FOR REGISTRANT’S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

The Company’s common stock is not listed on any exchange, nor is it included on NASDAQ. However, trades may be reported on the OTC Bulletin Board under the symbol “FNRN”. The Company is aware that Howe Barnes Hoefer & Arnett, Stone & Youngberg, Wedbush Morgan Securities and Monroe Securities, Inc., all currently make a market in the Company’s common stock. Management is aware that there are also private transactions in the Company’s common stock, and the data set forth below may not reflect all such transactions.

The following table summarizes the range of reported high and low bid quotations of the Company’s Common Stock for each quarter during the last two fiscal years and is based on information provided by Stone & Youngberg. The quotations reflect the price that would be received by the seller without retail mark-up, mark-down or commissions and may not have represented actual transactions:

QUARTER/YEAR	HIGH*	LOW*
4th Quarter 2008	$ 9.62	$ 5.77
3rd Quarter 2008	$10.00	$ 8.65
2nd Quarter 2008	$13.70	$ 9.86
1st Quarter 2008	$16.06	$13.22
4th Quarter 2007	$17.14	$14.29

3rd Quarter 2007	$17.23	$14.29
2nd Quarter 2007	$17.46	$15.73
1st Quarter 2007	$20.11	$16.78

* Price adjusted for dividends.

As of December 31, 2008, there were approximately 1,294 holders of record of the Company’s common stock, no par value, which is the only class of equity securities authorized or issued.

In the last two fiscal years the Company has declared the following stock dividends:

Shareholder Record Date	Dividend Percentage	Date Payable
February 27, 2009	4%	March 31, 2009
February 29, 2008	6%	March 31, 2008
February 28, 2007	6%	March 30, 2007

The Company does not expect to pay a cash dividend in the foreseeable future. Our ability to declare and pay dividends is affected by certain regulatory restrictions. See "Business – Restrictions on Dividends and Other Distributions" and "– Recent Events" above.

Purchases of Equity Securities by the Issuer or Affiliated Purchasers

On September 22, 2007, the Company approved a new stock repurchase program effective September 22, 2007 to replace the Company's previous stock repurchase plan that commenced May 1, 2006. The new stock repurchase program, which will remain in effect until September 21, 2009, allows repurchases by the Company in an aggregate of up to 4% of the Company's outstanding shares of common stock over each rolling twelve-month period. The Company repurchased no shares of the Company's outstanding common stock during the fourth quarter ended December 31, 2008. Our Tarp financing restricts our ability to repurchase our common stock, see "Business – Recent Events" above.

The Company made no purchases of its common stock during the quarter ended December 31, 2008:

Period	Total number of shares purchased	Average price paid per share	Total Number of shares purchased as part of publicly announced plan or program	Maximum number of shares that may yet be purchased under the plans or programs
October 1 – October 31, 2008	—	—	—	128,885
November 1 – November 30, 2008	—	—	—	231,806
December 1 – December 31, 2008	—	—	—	258,239
Total	—	—	—	258,239

ITEM 6 - SELECTED FINANCIAL DATA

The selected consolidated financial data below have been derived from the Company's audited consolidated financial statements. The selected consolidated financial data set forth below as of December 31, 2005, and 2004 have been derived from the Company's historical financial statements not included in this Report. The financial information for 2008, 2007 and 2006 should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations," which is in Part II (Item 7) of this Report and with the Company's audited consolidated financial statements and the notes thereto, which are included in Part II (Item 8) of this Report.

Consolidated Financial Data as of and for the years ended December 31,
(in thousands, except share and per share amounts)

	2008	2007	2006	2005	2004
Interest Income and Loan Fees	$ 38,871	$ 48,594	$ 48,070	$ 40,902	$ 31,619
Interest Expense	(6,375)	(11,738)	(9,426)	(5,729)	(3,426)
Net Interest Income	32,496	36,856	38,644	35,173	28,193
Provision for Loan Losses	(16,164)	(4,795)	(735)	(600)	(207)
Net Interest Income after Provision for Loan Losses	16,332	32,061	37,909	34,573	27,986
Other Operating Income	6,313	7,160	5,289	5,720	5,214
Other Operating Expense	(27,654)	(28,803)	(29,219)	(26,813)	(22,943)
(Loss) Income before Taxes	(5,009)	10,418	13,979	13,480	10,257
Benefit / (Provision) for Taxes	3,635	(3,137)	(5,169)	(4,792)	(3,550)
Net (Loss) / Income	$ (1,374)	$ 7,281	$ 8,810	$ 8,688	$ 6,707
Basic (Loss) / Income Per Share	$ (0.15)	$ 0.79	$ 0.95	$ 0.93	$ 0.71
Diluted (Loss) / Income Per Share	$ (0.15)	$ 0.77	$ 0.90	$ 0.89	$ 0.70
Total Assets	$ 670,802	$ 709,895	$ 685,225	$ 660,647	$ 629,503
Total Investments	$ 42,106	$ 74,849	$ 76,273	$ 48,788	$ 55,154
Total Loans, including Loans Held-for-Sale, net	$ 519,160	$ 499,314	$ 480,009	$ 460,501	$ 433,421
Total Deposits	$ 584,718	$ 622,671	$ 603,682	$ 581,781	$ 557,186
Total Equity	$ 62,029	$ 63,975	$ 61,990	$ 56,802	$ 51,901
Weighted Average Shares of Common Stock outstanding used for Basic (Loss) Income Per Share Computation 1	8,931,906	9,165,198	9,300,785	9,362,585	9,416,114
Weighted Average Shares of Common Stock outstanding used for Diluted (Loss) Income Per Share Computation 1	8,931,906	9,438,217	9,757,490	9,748,112	9,649,601

(Loss) Return on Average Total Assets	(0.20%)	1.05%	1.32%	1.35%	1.14%
Net (Loss) Income/Average Equity	(2.17%)	11.59%	14.90%	16.17%	13.73%
Net (Loss) Income/Average Deposits	(0.23%)	1.19%	1.49%	1.52%	1.28%
Average Loans/Average Deposits	87.21%	79.75%	81.20%	79.44%	75.81%
Average Equity to Average Total Assets	9.39%	9.06%	8.87%	8.37%	8.32%

1. All years have been restated to give retroactive effect for stock dividends issued and stock splits.

ITEM 7 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

This report includes forward-looking statements, which include forecasts of our financial results and condition, expectations for our operations and business, and our assumptions for those forecasts and expectations. Do not rely unduly on forward-looking statements. Actual results might differ significantly from our forecasts and expectations. Please refer to Part I, Item 1A “Risk Factors” for a discussion of some factors that may cause results to differ.

Introduction

This overview of Management’s Discussion and Analysis highlights selected information in this annual report and may not contain all of the information that is important to you. For a more complete understanding of trends, events, commitments, uncertainties, liquidity, capital resources and critical accounting estimates, you should carefully read this entire annual report.

Our subsidiary, First Northern Bank of Dixon, is a California state-chartered bank that derives most of its revenues from lending and deposit taking in the Sacramento Valley region of Northern California. Interest rates, business conditions and customer confidence all affect our ability to generate revenues. In addition, the regulatory environment and competition can challenge our ability to generate those revenues.

Financial highlights for 2008 include:

The Company reported a net loss of $1.37 million, a 118.9% decrease compared to net income of $7.28 million for 2007. Net loss per common share for 2008 of $0.15 resulted in a decrease of 119.0% compared to net income per common share of $0.79 for 2007, and net loss per common share on a fully diluted basis was $0.15 for 2008, a decrease of 119.5% compared to net income per common share on a fully diluted basis of $0.77 for 2007.

Loans (including loans held-for-sale) increased to $519.2 million at December 31, 2008, a 4.0% increase from $499.3 million at December 31, 2007. Commercial loans totaled $111.5 million at December 31, 2008, down 0.7% from $112.3 million a year earlier; agriculture loans were $38.3 million, up 4.2% from $36.8 million at December 31, 2007; real estate construction loans were $67.2 million, down 26.9% from $91.9 million at December 31, 2007; and real estate mortgage loans were $297.2 million, up 17.5% from $253.0 million a year earlier.

Average deposits decreased to $588.2 million during 2008, a $24.5 million or 4.0% decrease from 2007.

The Company reported average total assets of $674.8 million at December 31, 2008, down 2.7% from $693.4 million a year earlier.

The provision for loan losses in 2008 totaled $16,164,000, an increase of 237.1% from $4,795,000 in 2007. Net charge-offs were $12,605,000 in 2008 compared to $2,280,000 in 2007. The increase in the provision for loan losses and increase in net charge-offs can be primarily attributed to increased charge-offs combined with increased loan volume.

Net interest income totaled $32.5 million for 2008, a decrease of 11.8% from $36.9 million in 2007, primarily due to decreased loan rates and decreased Federal Funds volume and rates, which was partially offset by decreased deposit rates and increased loan volume.

Other operating income totaled $6.3 million for the year ended December 31, 2008, a decrease of 11.8% from $7.2 million for the year ended December 31, 2007. The decrease was due primarily to increases in write-downs of other real estate owned properties, which was partially offset by increased service charges on deposit accounts and investment and brokerage income.

Other operating expenses totaled $27.7 million for 2008, down 4.0% from $28.8 million in 2007. Contributing to the decrease was decreased salaries and employee benefits and advertising costs, which was partially offset by increased data processing expenses.

In 2009, the Company intends to continue its long-term strategy of maintaining deposit growth to fund growth in loans and other earning assets and intends to identify opportunities for growing other operating income in areas such as Asset Management and Trust and Investment and Brokerage Services, and deposit fee income, while remaining conscious of the need to maintain appropriate expense levels.

On March 13, 2009, the Company raised $17.39 million from the Treasury in a TARP financing. See Part I "Business—Recent Events," above for additional information.

Critical Accounting Policies and Estimates

The Company's discussion and analysis of its financial condition and results of operations are based upon the Company's consolidated 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 Company to make estimates and judgments that affect the reported amounts of assets, liabilities, income and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, the Company evaluates its estimates, including those related to the allowance for loan losses, other real estate owned, investments and income taxes. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

The Company's most significant estimates are approved by its senior management team. At the end of each financial reporting period, a review of these estimates is presented to the Company's Board of Directors.

The Company believes the following critical accounting policy affects its more significant judgments and estimates used in the preparation of its consolidated financial statements. The Company believes the allowance for loan losses accounting policy is critical because the loan portfolio represents the largest asset type on the consolidated balance sheet. The Company maintains an allowance for loan losses resulting from the inability of borrowers to make required loan payments. Loan losses are charged off against the allowance, while recoveries of amounts previously charged off are credited to the allowance. A provision for loan losses is charged to operations based on the Company's periodic evaluation of the factors mentioned below, as well as other pertinent factors. The allowance for loan losses consists of an allocated component and a general component. The components of the allowance for loan losses represent an estimation done pursuant to either Statement of Financial Accounting Standards No. ("SFAS") 5, Accounting for Contingencies, or SFAS 114, Accounting by Creditors for Impairment of a Loan. The allocated component of the allowance for loan losses reflects expected losses resulting from analyses developed through specific credit allocations for individual loans and historical loss experience for each loan category. The specific credit allocations are based on regular analyses of all loans where the internal credit rating is at or below a predetermined classification. These analyses involve a high degree of judgment in estimating the amount of loss associated with specific loans, including estimating the amount and timing of future cash flows and collateral values. The historical loan loss element is determined using analysis that examines loss experience.

The allocated component of the allowance for loan losses also includes consideration of concentrations and changes in portfolio mix and volume. The general portion of the allowance reflects the Company's estimate of probable inherent but undetected losses within the portfolio due to uncertainties in economic conditions, delays in obtaining information, including unfavorable information about a borrower's financial condition, the difficulty in identifying triggering events that correlate perfectly to subsequent loss rates, and risk factors that have not yet manifested themselves in loss allocation factors. Uncertainty surrounding the strength and timing of economic cycles also affects estimates of loss. There are many factors affecting the allowance for loan losses; some are quantitative while others require qualitative judgment. Although the Company believes its process for determining the allowance adequately considers all of the potential factors that could potentially result in credit losses, the process includes subjective elements and may be susceptible to significant change. To the extent actual outcomes differ from Company estimates, additional provision for credit losses could be required that could adversely affect earnings or financial position in future periods.

Other-than-temporary Impairment in Investment Securities

At each financial statement date, we assess whether declines in the fair value of held-to-maturity and available for-sale securities below their costs are deemed to be other than temporary. We consider, among other things, (i) the length of time and the extent to which the fair value has been less than cost, (ii) the financial condition and near-term prospects of the issuer, and (iii) our intent and ability to retain the investment for a period of time sufficient to allow for any anticipated recovery in fair value.

Evidence evaluated includes, but is not limited to, the remaining payment terms of the instrument and economic factors that are relevant to the collectability of the instrument, such as current prepayment speeds, the current financial condition of the issuer(s), industry analyst reports, credit ratings, credit default rates, interest rate trends and the value of any underlying collateral. Other than-temporary-impairment results in a charge to earnings and the corresponding establishment of a new cost basis for the security.

Share-Based Payment

On January 1, 2006, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 123R, "Share-Based Payments," which requires that all share-based payments, including stock options and non-vested restricted common shares, be recognized as an expense in the income statement based on the grant-date fair value of the award with a corresponding increase to common stock.

We determine the fair value of stock options at grant date using the Black-Scholes pricing model that takes into account the stock price at the grant date, the exercise price, the expected dividend yield, stock price volatility and the risk-free interest rate over the expected life of the option. The Black-Scholes model requires the input of highly subjective assumptions including the expected life of the stock-based award and stock price volatility. The estimates used in the model involve inherent uncertainties and the application of Management's judgment. As a result, if other assumptions had been used, our recorded stock-based compensation expense could have been materially different from that reflected in these financial statements. The fair value of non-vested restricted common shares generally equals the stock price at grant date. In addition, we are required to estimate the expected forfeiture rate and only recognize expense for those share-based awards expected to vest. If our actual forfeiture rate is materially different from the estimate, the share-based compensation expense could be materially different. For additional discussion of SFAS No.123R, see Note 13 to the Consolidated Financial Statements in this Form 10-K.

Accounting for Income Taxes

Income taxes reported in the financial statements are computed based on an asset and liability approach in accordance with FASB Statement No. 109, Accounting for Income Taxes CSFAS No. 109J. We recognize the amount of taxes payable or refundable for the current year, and deferred tax assets and liabilities for the expected future tax consequences that have been recognized in the financial statements. Under this method, deferred tax assets and liabilities are determined based on the differences between the financial statements and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. We record net deferred tax assets to the extent it is more likely than not that they will be realized. In evaluating our ability to recover the deferred tax assets, Management considers all available positive and negative evidence, including scheduled reversals of deferred tax liabilities, projected future taxable income, tax planning strategies and recent financial operations. In projecting future taxable income, Management develops assumptions including the amount of future state and federal pretax operating income, the reversal of temporary differences, and the implementation of feasible and prudent tax planning strategies. These assumptions require significant judgment about the forecasts of future taxable income and are consistent with the plans and estimates being used to manage the underlying business. The Company files consolidated federal and combined state income tax returns.

The Company adopted the provisions of FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes," on January 1, 2007, which clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB No. 109.

FIN 48 establishes a "more-likely-than-not" recognition threshold that must be met before a tax benefit can be recognized in the financial statements. For tax positions that meet the more-likely-than-not threshold, an enterprise may recognize only the largest amount of tax benefit that is greater than fifty percent likely of being realized upon ultimate settlement with the taxing authority. As a result of the implementation of FIN 48, the Company recognized an increase for unrecognized tax benefits. To the extent tax authorities disagree with these tax positions, our effective tax rates could be materially affected in the period of settlement with the taxing authorities. For additional discussion of FIN 48, see Note 9 to the Consolidated Financial Statements in this Form 10-K.

Prospective Accounting Pronouncements

In December 2007, the FASB issued SFAS No. 141R, Business Combinations, which requires most identifiable assets, liabilities, non-controlling interests, and goodwill acquired in a business combination to be recorded at “full fair value” at the acquisition date. SFAS No. 141R applies to all business combinations, including combinations among mutual entities and combinations by contract alone. Under SFAS No. 141R, all business combinations will be accounted for by applying the acquisition method. SFAS No. 141R is effective for periods beginning on or after December 15, 2008. Earlier application is prohibited. SFAS No. 141R will be applied to business combinations occurring after the effective date. The Company currently does not have any business combination contemplated that are expected to be closed after the effective date; therefore, the adoption of SFAS No. 141R will not have an impact, if any, on the consolidated financial statements or results of operations of the Company.

In December 2007, the SEC issued Staff Accounting Bulletin No. 110 (“SAB No. 110”), Certain Assumptions Used in Valuation Methods, which extends the use of the “simplified” method, under certain circumstances, in developing an estimate of expected term of “plain vanilla” share options in accordance with SFAS No. 123R. Prior to SAB No. 110, SAB No. 107 stated that the simplified method was only available for grants made up to December 31, 2007. The Company currently plans to continue to use the simplified method in developing an estimate of expected term of stock options.

In June, 2008, the FASB issued FASB Staff Position No. EITF 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions are Participating Securities, (“FSP EITF 03-6-1”). The Staff Position provides that unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents are participating securities and must be included in the earnings per share computation. FSP EITF 03-6-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those years. All prior-period earnings per share data presented must be adjusted retrospectively. Early application is not permitted. The adoption of the Staff Position will have no material effect on the Company’s financial position, results of operations or cash flows.

The FASB has issued FASB Statement No. 162, The Hierarchy of Generally Accepted Accounting Principals (SFAS 162). SFAS 162 is intended to improve financial statements that are presented in conformity with U.S. generally accepted accounting principals for nongovernmental entities. SFAS 162 is effective 60 days following the SEC’s approval of the PCAOB amendments to AU Section 411, The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principals. Management does not believe the adoption of SFAS 162 will have a material impact on the Company’s financial statements.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities (“SFAS 161”). SFAS 161 requires enhanced disclosures about an entity’s derivative and hedging activities and thereby improving the transparency of financial reporting. It is intended to enhance the current disclosure framework in SFAS 133 by requiring that objectives for using derivative instruments be disclosed in terms of underlying risk and accounting designation. This disclosure better conveys the purpose of derivative use in terms of the risks that the entity is intending to manage. SFAS 161 was effective for the Company on January 1, 2009 and will result in additional disclosures if the Company enters into any material derivative or hedging activities.

STATISTICAL INFORMATION AND DISCUSSION

The following statistical information and discussion should be read in conjunction with the Selected Financial Data included in Part II (Item 6) and the audited consolidated financial statements and accompanying notes included in Part II (Item 8) of this Annual Report on Form 10-K.

The following tables present information regarding the consolidated average assets, liabilities and stockholders' equity, the amounts of interest income from average earning assets and the resulting yields, and the amount of interest expense paid on interest-bearing liabilities. Average loan balances include non-performing loans. Interest income includes proceeds from loans on non-accrual status only to the extent cash payments have been received and applied as interest income. Tax-exempt income is not shown on a tax equivalent basis.

Distribution of Assets, Liabilities and Stockholders' Equity;
Interest Rates and Interest Differential
(Dollars in thousands)

	2008		2007		2006	
	Average Balance	Percent	Average Balance	Percent	Average Balance	Percent
ASSETS						
Cash and Due From Banks	$ 37,971	5.63%	$ 32,518	4.69%	$ 29,934	4.49%
Federal Funds Sold	26,808	3.97%	52,359	7.55%	61,904	9.29%
Investment Securities	57,123	8.46%	86,046	12.41%	64,770	9.72%
Loans 1	512,987	76.02%	488,704	70.48%	478,908	71.88%
Stock in Federal Home Loan Bank and other equity securities, at cost	2,253	0.33%	2,146	0.31%	2,087	0.31%
Other Real Estate Owned	3,691	0.55%	784	0.11%	78	0.01%
Other Assets	33,993	5.04%	30,882	4.45%	28,672	4.30%
Total Assets	$ 674,826	100.00%	$ 693,439	100.00%	$ 666,353	100.00%
LIABILITIES & STOCKHOLDERS' EQUITY						
Deposits:						
Demand	$ 173,332	25.69%	$ 185,563	26.77%	$ 187,766	28.18%
Interest-Bearing Transaction Deposits	128,690	19.07%	130,608	18.83%	95,180	14.28%
Savings & MMDAs	171,465	25.41%	179,425	25.87%	190,036	28.52%
Time Certificates	114,742	17.00%	117,178	16.90%	116,787	17.53%
Borrowed Funds	17,095	2.53%	10,504	1.51%	11,350	1.70%
Other Liabilities	6,147	0.91%	7,347	1.06%	6,113	0.92%
Stockholders' Equity	63,355	9.39%	62,814	9.06%	59,121	8.87%
Total Liabilities & Stockholders' Equity	$ 674,826	100.00%	$ 693,439	100.00%	$ 666,353	100.00%

1. Average balances for loans include loans held-for-sale and non-accrual loans and are net of the allowance for loan losses.

Net Interest Earnings
Average Balances, Yields and Rates
(Dollars in thousands)

	2008			2007			2006		
Assets	Average Balance	Interest Income/ Expense	Yields Earned/ Rates Paid	Average Balance	Interest Income/ Expense	Yields Earned/ Rates Paid	Average Balance	Interest Income/ Expense	Yields Earned/ Rates Paid
Loans 1	$ 512,987	$ 33,282	6.49%	$ 488,704	$ 39,220	8.03%	$ 478,908	$ 39,082	8.16%
Loan Fees	—	1,795	0.35%	—	2,268	0.46%	—	2,812	0.59%
Total Loans, Including Loan Fees	512,987	35,077	6.84%	488,704	41,488	8.49%	478,908	41,894	8.75%
Federal Funds Sold	26,808	519	1.94%	52,359	2,660	5.08%	61,904	2,986	4.82%
Due From Banks	13,428	557	4.15%	5,922	273	4.61%	—	—	—
Investment Securities: Taxable	27,578	1,344	4.87%	56,350	2,789	4.95%	50,958	2,448	4.80%
Non-taxable2	29,545	1,254	4.24%	29,696	1,271	4.28%	13,812	636	4.60%
Total Investment Securities	57,123	2,598	4.55%	86,046	4,060	4.72%	64,770	3,084	4.76%
Other Earning Assets	2,253	120	5.33%	2,146	113	5.27%	2,087	106	5.08%
Total Earning Assets	612,599	$ 38,871	6.35%	635,177	$ 48,594	7.65%	607,669	$ 48,070	7.91%
Cash and Due from Banks	24,543			26,596			29,934		
Premises and Equipment	8,355			8,123			8,188		

Other Real Estate Owned	3,691	784	78
Interest Receivable and Other Assets	25,638	22,759	20,484
Total Assets	$ 674,826	$ 693,439	$ 666,353

1. Average balances for loans include loans held-for-sale and non-accrual loans and are net of the allowance for loan losses, but non-accrued interest thereon is excluded.

2. Interest income and yields on tax-exempt securities are not presented on a tax equivalent basis.

Continuation of
Net Interest Earnings
Average Balances, Yields and Rates
(Dollars in thousands)

Liabilities and Stockholders' Equity	2008 Average Balance	2008 Interest Income/ Expense	2008 Yields Earned/ Rates Paid	2007 Average Balance	2007 Interest Income/ Expense	2007 Yields Earned/ Rates Paid	2006 Average Balance	2006 Interest Income/ Expense	2006 Yields Earned/ Rates Paid
Interest-Bearing Deposits:									
Interest-Bearing Transaction Deposits	$ 128,690	$ 930	0.72%	$ 130,608	$ 2,840	2.17%	$ 95,180	$ 1,568	1.65%
Savings & MMDAs	171,465	1,726	1.01%	179,425	4,034	2.25%	190,036	3,813	2.01%
Time Certificates	114,742	3,147	2.74%	117,178	4,551	3.88%	116,787	3,682	3.15%
Total Interest-Bearing Deposits	414,897	5,803	1.40%	427,211	11,425	2.67%	402,003	9,063	2.25%
Borrowed Funds	17,095	572	3.35%	10,504	313	2.98%	11,350	363	3.20%
Total Interest-Bearing Deposits and Funds	431,992	6,375	1.48%	437,715	11,738	2.68%	413,353	9,426	2.28%
Demand Deposits	173,332	—	—	185,563	—	—	187,766	—	—
Total Deposits and Borrowed Funds	605,324	$ 6,375	1.05%	623,278	$ 11,738	1.88%	601,119	$ 9,426	1.57%
Accrued Interest and Other Liabilities	6,147			7,347			6,113		
Stockholders' Equity	63,355			62,814			59,121		

Total Liabilities and Stockholders' Equity	$ 674,826			$ 693,439			$ 666,353		
Net Interest Income and Net Interest Margin 1		$ 32,496	5.30%		$ 36,856	5.80%		$ 38,644	6.36%
Net Interest Spread 2			4.87%			4.97%			5.63%

1. Net interest margin is computed by dividing net interest income by total average interest-earning assets.

2. Net interest spread represents the average yield earned on interest-earning assets less the average rate paid on interest-bearing liabilities.

Analysis of Changes
in Interest Income and Interest Expense
(Dollars in thousands)

Following is an analysis of changes in interest income and expense (dollars in thousands) for 2008 over 2007 and 2007 over 2006. Changes not solely due to interest rate or volume have been allocated proportionately to interest rate and volume.

	2008 Over 2007			2007 Over 2006		
	Volume	Interest Rate	Change	Volume	Interest Rate	Change
(Decrease) Increase in Interest Income:						
Loans	$ 2,077	$ (8,015)	$ (5,938)	$ 626	$ (488)	$ 138
Loan Fees	(473)	—	(473)	(544)	—	(544)
Federal Funds Sold	(945)	(1,196)	(2,141)	(502)	176	(326)
Due From Banks	308	(24)	284	273	—	273
Investment Securities	(1,321)	(141)	(4,162)	1,002	(26)	976
Other Assets	6	1	7	3	4	7
	$ (348)	$ (9,375)	$ (9,723)	$ 858	$ (334)	$ 524
(Decrease) Increase in Interest Expense:						
Deposits:						
Interest-Bearing						