



San Diego Trust

BANK

Performance You Can Trust.

2011 ANNUAL REPORT



Museum of Man bell tower

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San Diego Trust Bank is the only publicly traded community bank in the entire County to receive a BauerFinancial 5-Star designation for the past 22 consecutive quarters.

MESSAGE FROM MICHAEL E. PERRY, CHAIRMAN, PRESIDENT AND CEO



Dear Friend,

This past year will certainly be remembered as one of the most successful years ever for San Diego Trust Bank. The Bank finished 2011 with a record \$213 million in total assets, posted its 29th consecutive quarter of profitability, did not have a single past-due loan on its books, and reported record earnings that were 68% greater than the previous year! More importantly, we achieved such results without jeopardizing our depositor's funds, incurring undue risk, or impairing our shareholders' capital. These extraordinary results did not "just happen", they reflect the drive and determination of a talented team of bankers who understand the value of traditional banking and truly care about their clients.

I'm often asked by shareholders, clients, the media and many of our colleagues "how" have we been able to consistently produce such strong results over the years given all the macro-economic challenges we've been faced with since our founding in 2003. The answer is quite simple: "we focus on the needs of our clients, stay true to the fundamentals of banking, and execute in a manner that exceeds expectations."

Our model is not complex, nor is it difficult to understand. We safeguard our client's deposits, extend credit to them when needed in a prudent fashion, and invest the balance in low-risk government and corporate bonds. We do not reach, make risky bets on credit, or speculate on the direction of interest rates. While such may be considered a simple or "vanilla" approach, it has produced results that are unmatched in the San Diego community banking arena, and one that has allowed us to significantly enhance the value of our stakeholder's investment over the years.

The strength and stability of our institution, combined with the personal attention provided by our experienced team continues to attract those individuals and businesses seeking an alternative to the large, impersonal, Wall-Street banks. As one of the top performing community banks in San Diego, we are uniquely positioned to capitalize on the continued consolidation in our local market and are excited about prospects for future growth in assets, earnings, and the ability to further enhance the value of your investment in the Bank.

We are encouraged by the modest improvement in recent economic data, but move forward mindful of the fragility of the recovery and the many challenges that continue to confront our local and state economy. We enter 2012 with a fortress-like balance sheet, strong core earnings, significant capital, and most importantly, an exceptionally dynamic team of individuals committed to improving upon the success we've enjoyed to date.

Finally, I would like to extend my sincere appreciation to each and every one of you for your continued support, loyalty and confidence over the past eight years. You have my promise that every member of our team will continue to put forth their very best, and approach each day with passion, conviction, and an unrelenting quest to "continue" to deliver "*Performance You Can Trust*".

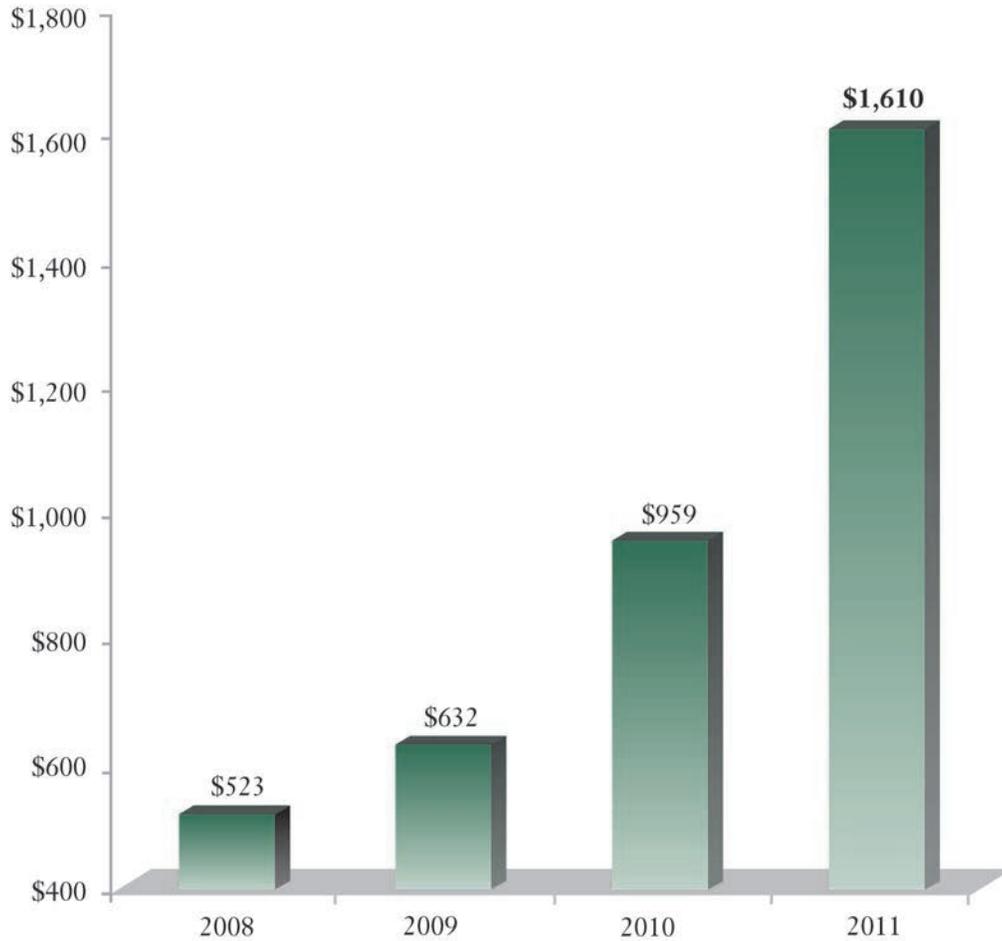
Very truly yours,

A handwritten signature in black ink, appearing to read "Michael E. Perry". The signature is stylized and fluid.

MICHAEL E. PERRY

EARNINGS PERFORMANCE

Net Income (In Thousands)



“Our never-ending commitment to the ‘fundamentals of banking’ have produced exceptional results over the years, regardless of economic conditions, interest rate fluctuations, or significant changes in the regulatory environment. Our clients and shareholders have benefitted greatly from this strategy and we remain focused on responsibly building the finest bank in our community.”

Michael E. Perry
Chairman, President and CEO

PERFORMANCE YOU CAN TRUST



2011 HIGHLIGHTS



- **Total assets climbed** to a record \$213 million.
- **Earnings increased** a record 68% compared to the previous year and totaled **\$1.61 million**.
- Recorded **Twenty-Ninth (29th) Consecutive Quarter** of Profitability – a feat unmatched by any other community bank in San Diego.
 - **Exceptional Asset Quality** reported with not a single past-due or non-performing loan in the portfolio as of 12/31/11.
- Total Risk Based Capital of 26.9% was among the **highest in the nation** and more than twice the amount needed to be considered “well-capitalized” by regulatory definition.
 - Bank was recognized as one of San Diego’s “**Best Small Companies**” to work for by the San Diego Business Journal.
- Recognized as a “**Premier Performing Bank**” by the Findley Companies based on exceptional financial performance.
 - Designated as a “**5-Star**” **Bank** by Bauer Financial, Inc. for the 22nd Consecutive Quarter – most of any bank in San Diego County.





Vavrinek, Trine, Day & Co., LLP
Certified Public Accountants and Consultants

INDEPENDENT AUDITORS' REPORT

Board of Directors and Shareholders of
San Diego Trust Bank

We have audited the accompanying statements of financial condition of San Diego Trust Bank as of December 31, 2011 and 2010 and the related statements of income, changes in shareholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of San Diego Trust Bank as of December 31, 2011 and 2010 and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Vavrinek, Trine, Day & Co., LLP

Laguna Hills, California
January 26, 2012

STATEMENTS OF FINANCIAL CONDITION

December 31, 2011 and 2010

	2011	2010
ASSETS		
Cash and Due from Banks	\$ 33,627,477	\$ 21,258,327
TOTAL CASH AND CASH EQUIVALENTS	33,627,477	21,258,327
Interest-Bearing Deposits in Other Financial Institutions	249,000	1,990,000
Investment Securities Available for Sale	130,793,142	120,941,553
Loans:		
Construction and Land Development	2,600,099	5,089,942
Commercial Real Estate	29,298,276	32,206,980
Residential Real Estate	2,417,081	5,302,332
Commercial and Industrial	5,409,178	6,547,147
Consumer	25,336	771,214
TOTAL LOANS	39,749,970	49,917,615
Deferred Loan Fees, Net of Costs	(85,678)	(30,137)
Allowance for Loan Losses	(1,463,000)	(1,463,000)
NET LOANS	38,201,292	48,424,478
Premises and Equipment	1,684,517	1,979,009
Other Real Estate Owned	751,631	811,631
Bank Owned Life Insurance	5,534,630	4,348,548
Federal Home Loan Bank Stock, at Cost	1,085,300	767,200
Prepaid FDIC Assessment	250,048	403,172
Accrued Interest and Other Assets	1,297,714	2,409,628
	\$ 213,474,751	\$ 203,333,546

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

STATEMENTS OF FINANCIAL CONDITION

December 31, 2011 and 2010

	2011	2010
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Noninterest-Bearing Demand	\$ 52,998,167	\$ 41,991,231
Savings, NOW and Money Market Accounts	104,359,450	114,125,056
Time Deposits Under \$100,000	1,469,190	2,214,681
Time Deposits \$100,000 and Over	9,677,397	12,799,234
TOTAL DEPOSITS	168,504,204	171,130,202
Other Borrowings	20,000,000	14,000,000
Accrued Interest and Other Liabilities	2,229,660	739,913
TOTAL LIABILITIES	190,733,864	185,870,115
Commitments and Contingencies - Notes D and J	-	-
Shareholders' Equity:		
Preferred Stock - 10,000,000 Shares Authorized, None Issued and Outstanding	-	-
Common Stock - No Par Value; Authorized 10,000,000 Shares; 2,083,783 Shares Issued and Outstanding in 2011 and 1,996,796 Shares Issued and Outstanding in 2010	14,427,775	13,665,279
Additional Paid-in Capital	1,088,101	981,181
Retained Earnings	3,762,312	2,900,533
Accumulated Other Comprehensive Income - Net Unrealized Gain (Loss) on Available-for-Sale Securities, net of Taxes of \$2,421,681 in 2011 and (\$58,440) in 2010	3,462,699	(83,562)
TOTAL SHAREHOLDERS' EQUITY	22,740,887	17,463,431
	\$ 213,474,751	\$ 203,333,546

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

STATEMENTS OF INCOME

For the Years Ended December 31, 2011 and 2010

	2011	2010
INTEREST INCOME		
Interest and Fees on Loans	\$ 2,848,699	\$ 3,294,235
Interest on Investment Securities:		
Taxable	3,092,457	2,572,178
Nontaxable	1,183,942	865,879
Other Interest Income	65,526	277,845
TOTAL INTEREST INCOME	7,190,624	7,010,137
INTEREST EXPENSE		
Interest on Savings Deposits, NOW and Money Market Accounts	548,188	721,514
Interest on Time Deposits	116,426	194,497
Interest on Borrowings	20,526	34,085
TOTAL INTEREST EXPENSE	685,140	950,096
NET INTEREST INCOME	6,505,484	6,060,041
Provision for Loan Losses	(272,833)	-
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	6,778,317	6,060,041
NONINTEREST INCOME		
Service Charges and Fees	227,202	292,823
Earnings on Cash Surrender Value of Life Insurance	209,438	187,258
Gain on Sale of Securities	226,692	13,520
TOTAL NONINTEREST INCOME	663,332	493,601
NONINTEREST EXPENSE		
Salaries and Employee Benefits	3,016,967	2,920,049
Occupancy and Equipment Expenses	1,097,197	933,910
Other Expenses	1,460,118	1,584,710
TOTAL NONINTEREST EXPENSE	5,574,282	5,438,669
INCOME BEFORE INCOME TAXES	1,867,367	1,114,973
Income Taxes	257,000	156,000
NET INCOME	\$ 1,610,367	\$ 958,973
NET INCOME PER SHARE - BASIC	\$ 0.78	\$ 0.47
NET INCOME PER SHARE - DILUTED	\$ 0.74	\$ 0.46

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

STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

For the Years Ended December 31, 2011 and 2010

	COMMON STOCK			ADDITIONAL PAID-IN CAPITAL	RETAINED EARNINGS	ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)	TOTAL
	COMPREHENSIVE INCOME	NUMBER OF SHARES	AMOUNT				
Balance at January 1, 2010		1,957,596	\$ 13,397,197	\$ 819,635	\$ 1,941,560	\$ 240,568	\$ 16,398,960
Exercise of Options including \$69,762 of Related Tax Benefits		39,200	268,082	69,762			337,844
Stock-Based Compensation				91,784			91,784
Comprehensive Income:							
Net Income	\$ 958,973				958,973		958,973
Reclassification Adjustment For Gains Included in Net Income, Net of tax of \$5,543	(7,977)					(7,977)	(7,977)
Unrealized Loss On Available-for-Sale Securities, Net of Taxes of \$219,700	(316,153)					(316,153)	(316,153)
Total Comprehensive Income	<u>\$ 634,843</u>						
Balance at December 31, 2010		1,996,796	13,665,279	981,181	2,900,533	(83,562)	17,463,431
Exercise of Options, including \$318,070 of Related Tax Benefits		27,100	13,908	33,611			47,519
Stock Dividend		59,887	748,588		(748,588)		
Stock-Based Compensation				73,309			73,309
Comprehensive Income:							
Net Income	\$1,610,367				1,610,367		1,610,367
Reclassification Adjustment For Gains Included in Net Income, Net of Tax of \$92,944	(133,748)					(133,748)	(133,748)
Unrealized Gain On Available-for-Sale Securities, Net of Taxes of \$2,557,294	3,680,009					3,680,009	3,680,009
Total Comprehensive Income	<u>\$5,156,628</u>						
Balance at December 31, 2011		<u>2,083,783</u>	<u>\$ 14,427,775</u>	<u>\$1,088,101</u>	<u>\$ 3,762,312</u>	<u>\$3,462,699</u>	<u>\$22,740,887</u>

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

STATEMENTS OF CASH FLOWS

For the Year Ended December 31, 2011 and 2010

	2011	2010
OPERATING ACTIVITIES		
Net Income	\$ 1,610,367	\$ 958,973
Adjustments to Reconcile Net Income to Net Cash		
From Operating Activities:		
Depreciation	306,402	202,075
Net Amortization on Securities	514,435	339,728
Provision for Loan Losses	(272,833)	-
Net Earnings on Bank Owned Life Insurance	(209,438)	(168,235)
Gain on Sale of Securities	(226,692)	(13,520)
Stock-Based Compensation	73,309	91,784
Deferred Income Tax (Benefit) Expense	(138,000)	42,000
Write-downs to Other Real Estate Owned	60,000	42,500
Other Items, net	436,020	(618,431)
NET CASH FROM OPERATING ACTIVITIES	2,153,570	876,874
INVESTING ACTIVITIES		
Net Change in Time Deposits in Other Financial Institutions	1,741,000	18,747,000
Purchase of Available-for-Sale Securities	(24,712,716)	(97,878,073)
Proceeds from Maturities of Available-for-Sale Securities	17,788,970	32,330,502
Proceeds from the Sale of Available-for-Sale Securities	2,810,796	7,663,764
Net Change in Loans	10,496,019	4,914,217
Redemption (Purchase) of Federal Home Loan Bank Stock	(318,100)	85,900
Purchase of Bank Owned Life Insurance	(1,000,000)	-
Purchases of Premises and Equipment	(11,910)	(622,761)
NET CASH FROM INVESTING ACTIVITIES	6,794,059	(34,759,451)
FINANCING ACTIVITIES		
Net Change in Demand Deposits and Savings Accounts	1,241,330	57,856,116
Net Change in Time Deposits	(3,867,328)	(3,652,739)
(Decrease) Increase in Borrowings	6,000,000	(4,150,000)
Proceeds from the Exercise of Stock Options	47,519	268,082
NET CASH FROM FINANCING ACTIVITIES	3,421,521	50,321,459
INCREASE IN CASH AND CASH EQUIVALENTS	12,369,150	16,438,882
Cash and Cash Equivalents at Beginning of Period	21,258,327	4,819,445
CASH AND CASH EQUIVALENTS AT END OF YEAR	\$33,627,477	\$21,258,327

Supplemental Disclosures of Cash Flow Information:

Interest Paid	\$ 671,631	\$ 921,252
Taxes Paid (Refunded)	\$ (2,364)	\$ 550,000

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

NOTES TO FINANCIAL STATEMENTS

December 31, 2011 and 2010

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

NATURE OF OPERATIONS

The Bank has been organized as a single operating segment and operates three full-service offices in the San Diego California metropolitan area. The Bank's primary source of revenue is from investment securities and also from providing loans to customers, who are predominately small and middle-market businesses and individuals.

SUBSEQUENT EVENTS

The Bank has evaluated subsequent events for recognition and disclosure through January 26, 2012, which is the date the financial statements were available to be issued.

USE OF ESTIMATES IN THE PREPARATION OF FINANCIAL STATEMENTS

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

CASH AND CASH EQUIVALENTS

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

CASH AND DUE FROM BANKS

Banking regulations require that banks maintain a percentage of their deposits as reserves in cash or on deposit with the Federal Reserve Bank. The Bank complied with the reserve requirements as of December 31, 2011.

The Bank maintains amounts due from banks, which may exceed federally insured limits. The Bank has not experienced any losses in such accounts.

INVESTMENT SECURITIES

Bonds, notes, and debentures for which the Bank has the positive intent and ability to hold to maturity are reported at cost, adjusted for premiums and discounts that are recognized in interest income using the interest method over the period to maturity. Investments not classified as trading securities nor as held-to-maturity securities are classified as available-for-sale securities and recorded at fair value. Unrealized gains or losses on available-for-sale securities are excluded from net income and reported as an amount net of taxes as a separate component of other comprehensive income included in shareholders' equity.

Premiums or discounts on held-to-maturity and available-for-sale securities are amortized or accreted into income using the interest method. Realized gains or losses on sales of held-to-maturity or available-for-sale securities are recorded on the trade date using the specific identification method.

Management evaluates securities for other-than-temporary impairment ("OTTI") on at least a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. For securities in an unrealized loss position, management considers the extent and duration of the unrealized loss, and the financial condition and near-term prospects of the issuer. Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the

entire difference between amortized cost and fair value is recognized as impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: 1) OTTI related to credit loss, which must be recognized in the income statement and 2) OTTI related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis. For equity securities, the entire amount of impairment is recognized through earnings.

LOANS

Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at their outstanding unpaid principal balances reduced by any charge-offs or specific valuation accounts and net of any deferred fees or costs on originated loans, or unamortized premiums or discounts on purchased loans.

Loan origination fees and certain direct origination costs are deferred and recognized in interest income using the level-yield method without anticipating prepayments.

Loans on which the accrual of interest has been discontinued are designated as nonaccrual loans. The accrual of interest on loans is discontinued when principal or interest is past due 90 days or when, in the opinion of management, there is reasonable doubt as to collectibility based on contractual terms of the loan. When loans are placed on nonaccrual status, all interest previously accrued but not collected is reversed against current period interest income. Income on nonaccrual loans is subsequently recognized only to the extent that cash is received and the loan's principal balance is deemed collectible. Interest accruals are resumed on such loans only when they are brought current with respect to interest and principal

and when, in the judgment of management, the loans are estimated to be fully collectible as to all principal and interest.

ALLOWANCE FOR LOAN LOSSES

The allowance for loan losses is a valuation allowance for probable incurred credit losses. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged off. Amounts are charged-off when available information confirms that specific loans or portions thereof, are uncollectible. This methodology for determining charge-offs is consistently applied to each portfolio segment.

The Bank determines a separate allowance for each portfolio segment. The allowance consists of specific and general reserves. Specific reserves relate to loans that are individually classified as impaired. A loan is impaired when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement or when a loan is determined to be a troubled debt restructuring as explained further below. Factors considered in determining impairment include payment status, collateral value and the probability of collecting all amounts when due. Measurement of impairment is based on the expected future cash flows of an impaired loan, which are to be discounted at the loan's effective interest rate, or measured by reference to an observable market value, if one exists, or the fair value of the collateral for a collateral-dependent loan. The Bank

selects the measurement method on a loan-by-loan basis except that collateral-dependent loans are measured at the fair value of the collateral.

The Bank recognizes interest income on impaired loans based on its existing methods of recognizing interest income on nonaccrual loans. Loans, for which the terms have been modified resulting in a concession, and for which the borrower is experiencing or has experienced financial difficulties, are considered troubled debt restructurings and classified as impaired with measurement of impairment as described above.

If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Smaller balance, homogeneous loans are collectively evaluated for impairment.

General reserves cover non-impaired loans and are based on historical loss rates for each portfolio segment, or industry data when no loss experience exists, adjusted for the effects of qualitative or environmental factors that are likely to cause estimated credit losses as of the evaluation date to differ from the portfolio segment's historical loss experience. Qualitative factors include consideration of the following: changes in lending policies and procedures; changes in economic conditions, changes in the nature and volume of the portfolio; changes in the experience, ability and depth of lending management and other relevant staff; changes in the volume and severity of past due, nonaccrual and other adversely graded loans; changes in the loan review system; changes in the value of the underlying collateral for collateral-dependent loans; concentrations of credit and the effect of other external factors such as competition and legal and regulatory requirements.

Portfolio segments identified by the Bank include construction and land development, commercial real estate, residential real estate, commercial and industrial and consumer loans. Relevant risk characteristics for these portfolio segments generally include debt service coverage, loan-to-value ratios and financial performance on non-consumer loans and credit history, debt-to income, collateral type and loan-to-value ratios for consumer loans.

PREMISES AND EQUIPMENT

Premises and equipment are carried at cost less accumulated depreciation and amortization. Depreciation is computed using the straight-line method over the estimated useful lives, which ranges from three to seven years for furniture and equipment. Leasehold improvements are amortized using the straight-line method over the estimated useful lives of the improvements or the remaining lease term, whichever is shorter. Expenditures for betterments or major repairs are capitalized and those for ordinary repairs and maintenance are charged to operations as incurred.

OTHER REAL ESTATE OWNED

Other real estate owned ("OREO") represents properties acquired through foreclosure or other proceedings. OREO is held for sale and is recorded at the lower of the recorded amount of the loan or fair value of the properties less estimated costs of disposal. Any write-down to fair value at the time of transfer to OREO is charged to the allowance for loan losses. Property is evaluated regularly to ensure the recorded amount is supported by its current fair value and valuation allowances to reduce the carrying amounts to fair value less estimated costs to dispose are recorded as necessary. Additions to or reductions from valuation allowances are recorded in other expense. Operating costs after acquisition are expensed.

BANK OWNED LIFE INSURANCE

Bank owned life insurance is recorded at the amount that can be realized under insurance contracts at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

FEDERAL HOME LOAN BANK (“FHLB”) STOCK

The Bank is a member of the FHLB system. Members are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. FHLB stock is carried at cost, classified as a restricted security, and is periodically evaluated for impairment.

TRANSFERS OF FINANCIAL ASSETS

Transfers of financial assets are accounted for as sales, when control over the assets has been relinquished. Control over transferred assets is deemed to be surrendered when the assets have been isolated from the Bank, the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and the Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

INCOME TAXES

Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized. Tax effects from an uncertain tax position are recognized in the financial statements only if, based on its merits, the position is more likely than not to be sustained on audit by the taxing authorities. Interest and penalties related to uncertain tax positions are recorded as part of income tax expense.

COMPREHENSIVE INCOME

The change in unrealized gains and losses on available-for-sale securities is the only component of accumulated other comprehensive income for the Bank.

FINANCIAL INSTRUMENTS

In the ordinary course of business, the Bank has entered into off-balance sheet financial instruments consisting of commitments to extend credit, commercial letters of credit, and standby letters of credit as described in Note J. Such financial instruments are recorded in the financial statements when they are funded or related fees are incurred or received.

EARNINGS PER SHARE (“EPS”)

Basic EPS excludes dilution and is computed by dividing income available to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if options or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity. The Bank issued a 3% stock dividend in 2011. The per share data in the Statements of Income and accompanying footnotes have been adjusted to give retroactive effect to this dividend.

STOCK-BASED COMPENSATION

Compensation cost is recognized for stock options issued to employees, based on the fair value of these awards at the date of grant. A Black-Scholes model is utilized to estimate the fair value of stock options. This cost is recognized over the period which an employee is required to provide services in exchange for the award, generally defined as the vesting period.

FAIR VALUE MEASUREMENT

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market

participants on the measurement date. Current accounting guidance establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. There are three levels of inputs that may be used to measure fair values:

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

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

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

See Note N for more information and disclosures relating to the Bank's fair value measurements.

RECLASSIFICATIONS

Certain reclassifications have been made in the 2010 financial statements to conform to the presentation used in 2011. These reclassifications had no impact on the Bank's previously reported financial statements.

ADOPTION OF NEW ACCOUNTING STANDARDS

In July 2010, the Financial Accounting Standard Board ("FASB") amended guidance to require significantly more information about the credit quality of the Bank's loan portfolio. The Bank had previously included period-end related disclosures as required by the new amendment. Newly required activity related disclosures are effective for interim and annual reporting periods ending after December 15, 2011 and are included in these financial statements.

In April 2011, the FASB amended existing guidance for assisting a creditor in determining whether a restructuring is a troubled debt restructuring ("TDR"). The amendments clarify the guidance for a creditor's evaluation of whether it has granted a concession and whether a debtor is experiencing financial difficulties. This guidance was effective for interim and annual reporting periods beginning after June 15, 2011, and is to be applied retrospectively to the beginning of the annual period of adoption. The new guidance did not have a significant impact on the Bank's determination of whether a restructuring is a TDR.

NEWLY ISSUED BUT NOT YET EFFECTIVE STANDARDS

In May 2011, the FASB issued an amendment to achieve common fair value measurement and disclosure requirements between U.S. and International accounting principles. Overall, the guidance is consistent with existing U.S. accounting principles; however, there are some amendments that change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. The amendment in this guidance will be effective for interim and annual reporting periods beginning after December 15, 2011. The amendment is not expected to significantly impact the Bank.

In September 2011, the FASB amended existing guidance and eliminated the option to present the components of other comprehensive income as part of the statement of changes in shareholders' equity. The amendment requires that comprehensive income be presented in either a single continuous statement or in two separate consecutive statements. This amendment will be effective for interim and annual reporting periods beginning after December 15, 2011. The adoption of this amendment will change the presentation of the components of comprehensive income for the Bank as part of the statement of shareholders' equity.

NOTE B – INVESTMENT SECURITIES

The following table summarizes the amortized cost and fair value of the available-for-sale securities portfolio at December 31, 2011 and 2010, and the corresponding amounts of gross unrealized gains and losses recognized in accumulated other comprehensive

gains of \$226,692 and \$23,520 and gross losses of \$0 and \$10,000, respectively.

As of December 31, 2011 and 2010, no security had been in a continuous loss position for a period of more than twelve consecutive months. Unrealized losses on one corporate bond and one mortgage-

	AMORTIZED COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	FAIR VALUE
December 31, 2011:				
U.S. Government Agencies	\$ 2,276,866	\$ 1,259	\$ -	\$ 2,278,125
Municipal Bonds	30,548,865	2,228,519	-	32,777,384
Corporate Bonds	12,872,229	818,615	(193,859)	13,496,985
Mortgage-backed Securities:	79,210,801	3,036,657	(6,810)	82,240,648
	\$124,908,761	\$ 6,085,050	\$ (200,669)	\$130,793,142
December 31, 2010:				
U.S. Government Agencies	\$ 9,373,114	\$ 48,919	\$ (236,700)	\$ 9,185,333
Municipal Bonds	30,626,040	114,212	(1,020,019)	29,720,233
Corporate Bonds	9,895,893	846,511	-	10,742,404
Mortgage-backed Securities	71,188,508	807,442	(702,367)	71,293,583
	\$121,083,555	\$ 1,817,084	\$ (1,959,086)	\$120,941,553

income (loss): All mortgage-backed securities owned by the Bank at December 31, 2011 and 2010, were issued by U.S. Government agencies or Government Sponsored entities which carry either the explicit or implicit guarantee of the United States Government. All Corporate Bonds are of companies which are Fortune 100 corporations and are rated AA or above.

Municipal Bonds are all rated AA or higher by Standard & Poors or Moody's and additionally, carry insurance issued by the top rated municipal bond insurer in the nation or are guaranteed by specific funds by the individual states.

The scheduled maturities of securities at December 31, 2011, were as follows:

During 2011 and 2010, the Bank received proceeds of \$2,810,796 and \$7,663,764 from the sale of securities and recognized gross

backed security have not been recognized into income because the issuer bonds are of high credit quality (rated AA or above), management does not intend to sell and it is not more likely than not that management would be required to sell the securities prior to their anticipated recovery, and the decline in fair value is largely due to changes in interest rates and investor sentiment.

Securities with a fair value of approximately \$32.4 million at December 31, 2011, were pledged to the Federal Home Loan Bank to secure borrowings as discussed in Note G.

	AVAILABLE-FOR-SALE	
	AMORTIZED COST	FAIR VALUE
Due in One Year or Less	\$ -	\$ -
Due from One Year to Five Years	11,627,741	12,049,772
Due from Five Years to Ten Years	4,637,245	5,170,120
Over Ten Years	29,432,974	31,332,602
Mortgage-backed Securities	79,210,801	82,240,648
	\$124,908,761	\$130,793,142

NOTE C – LOANS

The Bank's loan portfolio consists primarily of loans to borrowers within San Diego County, California. Although the Bank seeks to avoid concentrations of loans to a single industry or based upon a single class of collateral, real estate and real estate associated businesses are among the principal industries in the Bank's market area and, as a result, the Bank's loan and collateral portfolios are, to some degree, concentrated in those industries.

The Bank has pledged loans with a carrying value of approximately \$10.3 million to secure a line of credit with the Federal Home Loan Bank as discussed in Note G.

A summary of the changes in the allowance for loan losses as of December 31 is as follows:

	2011	2010
Beginning Balance	\$1,463,000	\$ 1,550,000
Charge-Offs	-	(87,000)
Recoveries	272,833	-
Provisions	(272,833)	-
Ending Balance	\$1,463,000	\$ 1,463,000

The following table presents the activity in the allowance for loan losses for the year 2011 and the recorded investment in loans and impairment method as of December 31, 2011 and 2010, by portfolio segment:

The Bank categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as current financial information, historical payment experience, collateral adequacy, credit documentation, and current economic trends, among other factors.

The Bank analyzes loans individually by classifying the loans as to credit risk. This analysis typically includes larger, non-homogeneous loans such as commercial real estate and commercial and industrial loans. This analysis is performed on an ongoing basis as new information is obtained.

DECEMBER 31, 2011	CONSTRUCTION AND LAND DEVELOPMENT	COMMERCIAL REAL ESTATE	RESIDENTIAL REAL ESTATE	COMMERCIAL	CONSUMER	TOTAL
Allowance for Loan Losses:						
Beginning of Year	\$ 187,842	\$ 854,654	\$ 119,645	\$ 263,841	\$ 37,018	\$ 1,463,000
Charge -offs	-	-	-	-	-	-
Recoveries	-	-	272,833	-	-	272,833
Provisions	(67,588)	70,443	(311,989)	71,913	(35,612)	(272,833)
End of Year	\$ 120,254	\$ 925,097	\$ 80,489	\$ 335,754	\$ 1,406	\$ 1,463,000
Reserves:						
Specific	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
General	120,254	925,097	80,489	335,754	1,406	1,463,000
	\$ 120,254	\$ 925,097	\$ 80,489	\$ 335,754	\$ 1,406	\$ 1,463,000
Loans Evaluated For Impairment:						
Individually	\$ -	\$ 989,300	\$ -	\$ -	\$ -	\$ 989,300
Collectively	2,600,099	28,308,976	2,417,081	5,409,178	25,336	38,760,670
	\$ 2,600,099	\$ 29,298,276	\$ 2,417,081	\$ 5,409,178	\$ 25,336	\$ 39,749,970

DECEMBER 31, 2010	CONSTRUCTION AND LAND DEVELOPMENT	COMMERCIAL REAL ESTATE	RESIDENTIAL REAL ESTATE	COMMERCIAL	CONSUMER	TOTAL
Reserves:						
Specific	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
General	187,842	854,654	119,645	263,841	37,018	1,463,000
	\$ 187,842	\$ 854,654	\$ 119,645	\$ 263,841	\$ 37,018	\$ 1,463,000
Loans Evaluated For Impairment:						
Individually	\$ -	\$ 1,012,313	\$ 1,148,000	\$ -	\$ -	\$ 2,160,313
Collectively	5,089,942	31,194,667	4,154,332	6,547,147	771,214	47,757,302
	\$ 5,089,942	\$ 32,206,980	\$ 5,302,332	\$ 6,547,147	\$ 771,214	\$ 49,917,615

The federal regulatory agencies use the following definitions for risk ratings:

Pass – Loans classified as pass include loans not meeting the risk ratings defined below.

Special Mention - Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date.

Substandard - Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the

obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Impaired – A loan is considered impaired, when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement. Additionally, all loans classified as troubled debt restructurings are considered impaired.

The risk category of loans by class of loans is as follows as of December 31, 2011 and 2010:

	PASS	SPECIAL MENTION	SUBSTANDARD	IMPAIRED	TOTAL
December 31, 2011					
Construction and Land Development	\$ 2,600,099	\$ -	\$ -	\$ -	\$ 2,600,099
Commercial Real Estate	27,995,486	313,490	-	989,300	29,298,276
Residential Real Estate	2,417,081	-	-	-	2,417,081
Commercial and Industrial	4,844,657	-	564,521	-	5,409,178
Consumer	25,336	-	-	-	25,336
	\$ 37,882,659	\$ 313,490	\$ 564,521	\$ 989,300	\$ 39,749,970
December 31, 2010					
Construction and Land Development	\$ 5,089,942	\$ -	\$ -	\$ -	\$ 5,089,942
Commercial Real Estate	27,682,835	3,511,832	-	1,012,313	32,206,980
Residential Real Estate	4,154,332	-	-	1,148,000	5,302,332
Commercial and Industrial	5,836,291	-	710,856	-	6,547,147
Consumer	771,214	-	-	-	771,214
	\$ 43,534,614	\$ 3,511,832	\$ 710,856	\$ 2,160,313	\$ 49,917,615

The Bank had no past due loans as of December 31, 2011 and 2010. The Bank had no nonaccrual loans as of December 31, 2011 and one residential real estate loan classified as nonaccrual in the amount of \$1,148,000 as of December 31, 2010.

Information relating to individually impaired loans presented by class of loans was as follows as of December 31, 2011 and 2010:

	UNPAID PRINCIPLE BALANCE	RECORDED INVESTMENT	RELATED RESERVES	AVERAGE RECORDED INVESTMENT	INTEREST INCOME RECOGNIZED
December 31, 2011					
With no Related Allowance Recorded					
Commercial Real Estate	\$ 989,300	\$ 989,300	\$ -	\$ 1,000,807	\$ 50,246
December 31, 2010					
With no Related Allowance Recorded					
Commercial Real Estate	\$ 1,012,313	\$ 1,012,313	\$ -	\$ 1,013,763	\$ 50,716
Residential Real Estate	1,560,000	1,148,000	-	1,232,000	-
	\$ 2,572,313	\$ 2,160,313	\$ -	\$ 2,245,763	\$ 50,716

One loan identified as a troubled debt restructuring amounted to \$989,300 and \$1,012,313 as of December 31, 2011 and 2010, respectively and the Bank has allocated \$0 specific reserves on this loan as payments are being made as agreed and a current appraisal supports the carrying value.

NOTE D – PREMISIES AND EQUIPMENT

A summary of premises and equipment as of December 31 follows:

	2011	2010
Furniture, Fixtures, and Equipment	\$ 1,337,045	\$ 1,344,325
Leasehold Improvements	1,638,822	1,716,182
	2,975,867	3,060,507
Less Accumulated Depreciation and Amortization	(1,291,350)	(1,081,498)
	\$ 1,684,517	\$ 1,979,009

Depreciation expense was \$306,402 and \$202,275 for 2011 and 2010, respectively.

The Bank leases various facilities under noncancellable operating leases expiring through 2020. At December 31, 2011, the future minimum lease commitments under noncancellable operating lease commitments were as follows:

YEAR ENDING	LEASE COMMITMENTS
2012	\$ 526,451
2013	466,562
2014	417,215
2015	429,344
2016	442,274
Thereafter	599,504
Total	\$ 2,881,350

The minimum rental payments shown above are given for the existing lease obligations and are not a forecast of future rental expense. Total rental expense, including common area expenses and net of sub-lease income was \$509,418 and \$464,891 for 2011 and 2010. Sub-lease income was \$78,855 and \$115,565 in 2011 and 2010, respectively.

NOTE E – DEPOSITS

At December 31, 2011, the scheduled maturities of time deposits are approximately as follows:

Due in One Year or Less	\$ 9,168,817
Due from One to Three Years	1,977,770
	<u>\$ 11,146,587</u>

NOTE F – RELATED PARTY TRANSACTIONS

Loans granted to executive officers, directors and their related interests with which they are associated totaled approximately \$1,873,881 and \$5,931,341 as of December 31, 2011 and 2010, respectively.

Deposits from executive officers, directors and their related interests with which they are associated held by the Bank at December 31, 2011 and 2010, amounted to approximately \$4,003,169 and \$2,664,000, respectively.

NOTE G – OTHER BORROWING

The Bank has a borrowing arrangement with the Federal Home Loan Bank of San Francisco. The Bank can borrow up to approximately \$35.5 million against which it has pledged approximately \$10.3 million of its real estate secured loans and \$32.4 million in investment securities.

As of December 31, 2011, the Bank had borrowed \$20,000,000 under this arrangement with \$10,000,000 due on January 3, 2012, bearing interest at 0.05% and \$10,000,000 due on June 14, 2012 bearing interest at 0.27%.

The Bank may borrow up to \$14,000,000 on an unsecured basis from three correspondent banks. As of December 31, 2011, no amounts were outstanding and no assets had been pledged under these arrangements.

NOTE H – INCOME TAXES

The asset and liability method is used in accounting for income taxes. Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse.

The provision for income taxes consists of the following:

	2011	2010
Currently payable	\$ 395,000	\$ 114,000
Deferred taxes	(138,000)	42,000
	<u>\$ 257,000</u>	<u>\$ 156,000</u>

A comparison of the federal statutory income tax rates to the Bank's effective income tax rates at December 31 follows:

	2011		2010	
	AMOUNT	RATE	AMOUNT	RATE
Statutory Federal Tax	\$ 635,000	34.0%	\$ 379,000	34.0%
State Franchise Tax, Net of Federal Benefit	125,000	6.7%	74,000	6.6%
Tax Free Income on Life Insurance Policies	(63,000)	(3.4%)	(57,000)	(5.1%)
Tax Exempt Interest Income	(396,000)	(21.2%)	(286,000)	(25.7%)
Other Items, Net	(44,000)	(2.3%)	46,000	4.2%
Actual Tax Expense	\$ 257,000	13.8%	\$ 156,000	14.0%

Deferred taxes are a result of differences between income tax accounting and generally accepted accounting principles with respect to income and expense recognition. The following is a summary of the components of the net deferred tax asset (liability) accounts recognized in the accompanying statements of financial condition at December 31:

	2011	2010
Deferred Tax Assets:		
Allowance for Loan Losses Due to Tax Limitations	\$ 450,000	\$ 562,000
Other Real Estate Owned	122,000	97,000
Deferred Compensation	196,000	148,000
Unrecognized Loss on Available-for-Sale Securities	-	58,000
Other Items	284,000	153,000
	1,052,000	1,018,000
Valuation Allowance	-	-
Deferred Tax Liabilities:		
Depreciation Differences	(202,000)	(247,000)
Deferred Loan Costs	(45,000)	(20,000)
Unrecognized Gain on Available-for-Sale Securities	(2,422,000)	-
Other Items	(62,000)	(88,000)
	(2,731,000)	(355,000)
Net Deferred Tax Assets (Liability)	\$ (1,679,000)	\$ 663,000

The Bank has a net operating loss carry forward of \$40,080 for California franchise tax purposes. California net operating loss carry forwards, to the extent not used will expire in 2017. The Bank also has an alternative minimum tax credit carry forward of \$78,703 which does not expire.

The Bank is subject to federal income tax and California franchise tax. Federal income tax returns for the years ended December 31, 2010, 2009 and 2008, are open to audit by the federal authorities and California returns for the years ended December 31, 2010, 2009, 2008 and 2007, are open to audit by State authorities.

NOTE I – OTHER EXPENSES

Other expenses as of December 31 are comprised of the following:

	2011	2010
Professional Fees	\$ 547,849	\$ 593,410
Marketing and Business Promotion	76,427	107,444
Office Expenses	187,248	173,360
Correspondent Bank Charges	53,364	55,044
Messenger and Delivery Services	48,776	45,106
FDIC Assessments	138,000	232,158
Write-downs on Other Real Estate Owned	60,000	42,500
Other Expenses	348,454	335,688
	\$1,460,118	\$ 1,584,710

NOTE J – COMMITMENTS

In the ordinary course of business, the Bank enters into financial commitments to meet the financing needs of its customers. These financial commitments include commitments to extend credit and standby letters of credit. Those instruments involve to varying degrees, elements of credit and interest rate risk not recognized in the Bank's financial statements.

The Bank's exposure to loan loss in the event of nonperformance on commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments as it does for loans reflected in the financial statements. As of December 31, the Bank had the following outstanding financial commitments whose contractual amount represents credit risk:

	2011	2010
Commitments to Extend Credit	\$ 5,418,801	\$ 7,777,243

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Since many of the commitments are expected to expire without being drawn upon, the total amounts do not necessarily represent future cash requirements. The Bank evaluates each client's credit worthiness on a case-by-case basis. The amount of collateral obtained if deemed necessary by the Bank is based on management's credit evaluation of the customer.

The Bank has purchased life insurance on several key executives to which the Bank is the sole beneficiary of such policies. The tax-free income generated from these policies is utilized to offset the costs of employee benefits, including, but not limited to health insurance premiums, workers' compensation insurance, and 401k expense. A portion is also being accrued in contemplation of certain supplemental retirement agreements that have been entered into with certain key executives.

The amounts due under such agreements vary greatly, are generally payable at age 65, are payable over a ten-year period, and are subject to achieving certain vesting requirements. The estimated present value of future benefits to be paid is being accrued over the period from the effective date of the agreements until the expected retirement dates of the participants. The amounts accrued as of December 31, 2011 and 2010, were \$475,860 and \$398,263, respectively.

NOTE K - EARNINGS PER SHARE “EPS”

The following is a reconciliation of net income and shares outstanding to the income and number of shares used to compute EPS:

	2011		2010	
	INCOME	SHARES	INCOME	SHARES
Net Income as Reported	\$1,610,367		\$ 958,973	
Shares Outstanding at Year End		2,083,738		2,056,700
Impact of Weighting Shares Purchased During the Year		(12,112)		(18,094)
Used in Basic EPS	1,610,367	2,071,626	958,973	2,038,606
Dilutive Effect of Outstanding Stock Options		101,748		38,780
Used in Dilutive EPS	\$1,610,367	2,173,374	\$ 958,973	2,077,385

NOTE L – STOCK OPTION PLAN

Under the terms of the 2003 Stock Plan (as amended and restated in 2011), officers and key employees may be granted both nonqualified and incentive stock options and directors and other consultants, who are not also an officer or employee, may only be granted nonqualified stock options. The Plan provides for options to purchase 756,020 shares of common stock at a price not less than 100 percent of the fair market value of the stock on the date of grant. Stock options expire no later than ten years from the date of the grant.

No options were granted in 2011. The fair value of each option granted in 2010, was estimated on the date of the grant using the Black-Scholes option pricing model with the following weighted average assumptions:

	2010
Risk Free Interest Rate	1.92%
Estimated Average Life	6.5 years
Expected Dividend Rates	0.00%
Expected Stock Volatility	15.00%
Weighted-Average Option Value	\$ 2.35

The Bank recognized stock-based compensation expense of \$73,309 and \$91,784 and income tax benefits on that expense of approximately \$8,700 in both 2011 and 2010.

A summary of the status of the Bank's stock option plan as of December 31, 2011 and changes during the year then ended is presented below:

	SHARES	WEIGHTED-AVERAGE EXERCISE PRICE	WEIGHTED-AVERAGE REMAINING CONTRACTUAL TERM	AGGREGATE INTRINSIC VALUE
Outstanding at Beginning of Year	401,855	\$ 9.54		
Granted	-	\$ -		
Exercised	(65,770)	\$ 6.47		
Forfeited	(9,788)	\$ 17.10		
Outstanding at End of Year	326,297	\$ 9.94	4.0 Years	\$ 1,538,169
Options Exercisable	284,719	\$ 10.04	3.5 Years	\$ 1,311,130

The total intrinsic value of options exercised during the years ended December 31, 2011 and 2010 was \$773,000 and \$267,000, respectively. As of December 31, 2011, there was approximately \$26,000 of total unrecognized compensation cost related to outstanding stock options that will be recognized over a weighted average period of 1.2 years.

Out of 65,770 shares exercised in 2011, 59,270 were exercised on a cashless net settlement basis, which is permitted under the 2003 Plan as amended. In these exercise transactions option holders are not required to tender cash payment for shares purchased, but rather have the Bank issue to them fewer shares than the number of options being exercised with reductions in the shares issued to cover the cost to exercise the shares and the amount of tax withholding payments required to be made by the Bank on behalf of the option holder. In 2011, the Bank issued 20,555 shares to satisfy the cashless exercises of 59,270 option shares.

NOTE M – REGULATORY MATTERS

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements could initiate certain mandatory - and possibly additional discretionary - actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. The Bank has never been subject to any regulatory order since inception.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined). Management believes, as of December 31, 2011, that the Bank meets all capital adequacy requirements to which it is subject. As of December 31, 2011, the most recent notification from the Federal Deposit Insurance Corporation (the "FDIC") categorized the Bank as well capitalized under the regulatory framework for prompt corrective action (there are no conditions or events since that notification that management believes have changed the Bank's category). To be categorized as well capitalized, the Bank must maintain minimum ratios as set forth in the table below. The following table also sets forth the Bank's actual capital amounts and ratios (dollar amounts in thousands):

	AMOUNT OF CAPITAL REQUIRED					
	ACTUAL		FOR CAPITAL ADEQUACY PURPOSES		TO BE WELL-CAPITALIZED UNDER PROMPT CORRECTIVE PROVISIONS	
	AMOUNT	RATIO	AMOUNT	RATIO	AMOUNT	RATIO
As of December 31, 2011:						
Total Capital (to Risk-Weighted Assets)	\$20,226	26.9%	\$ 6,026	8.0%	\$ 7,533	10.0%
Tier 1 Capital (to Risk-Weighted Assets)	\$19,278	25.6%	\$ 3,013	4.0%	\$ 4,520	6.0%
Tier 1 Capital (to Average Assets)	\$19,278	9.2%	\$ 8,318	4.0%	\$10,397	5.0%
As of December 31, 2010:						
Total Capital (to Risk-Weighted Assets)	\$ 18,584	22.5%	\$ 6,605	8.0%	\$ 8,256	10.0%
Tier 1 Capital (to Risk-Weighted Assets)	\$ 17,547	21.3%	\$ 3,302	4.0%	\$ 4,953	6.0%
Tier 1 Capital (to Average Assets)	\$ 17,547	8.7%	\$ 8,017	4.0%	\$10,021	5.0%

The California Financial Code provides that a bank may not make cash distribution to its shareholders in excess of the lesser of the Bank's undivided profits or the Bank's net income for its last three fiscal years less the amount of any distribution made by the Bank to shareholders during the same period.

NOTE N – FAIR VALUE MEASUREMENT

The following is a description of valuation methodologies used for assets and liabilities recorded at fair value:

Securities: The fair values of securities available for sale are determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1) or matrix pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted prices for specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2).

Collateral-Dependent Impaired Loans: The Bank does not record loans at fair value on a recurring basis. However, from time to time, fair value adjustments are recorded on these loans to reflect (1) partial write-downs, through charge-offs or specific reserve allowances, that are based on the current appraised or market-quoted value of the underlying collateral or (2) the full charge-off of the loan carrying value. In some cases, the properties for which market quotes or appraised values have been obtained are

located in areas where comparable sales data is limited, outdated, or unavailable. Fair value estimates for collateral-dependent impaired loans are obtained from real estate brokers or other third-party consultants. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available and such adjustments are typically significant (Level 3).

Other Real Estate Owned: Nonrecurring adjustments to certain commercial and residential real estate properties classified as other real estate owned "OREO" are measured at the lower of carrying amount or fair value, less costs to sell. Fair values are generally based on third party appraisals of the property, resulting in a Level 3 classification. In cases where the carrying amount exceeds the fair value, less costs to sell, an impairment loss is recognized.

The following table provides the hierarchy and fair value for each major category of assets and liabilities measured at fair value at December 31, 2011 and 2010:

	FAIR VALUE MEASUREMENTS AS OF DECEMBER 31, 2011			
	LEVEL 1	LEVEL 2	LEVEL 3	TOTAL
Assets Measured at Fair Value:				
Recurring Basis				
Securities Available for Sale	\$ -	\$130,793,142	\$ -	\$130,793,142
Non-recurring Basis				
Other Real Estate Owned, Net	\$ -	\$ -	\$ 751,631	\$ 751,631
FAIR VALUE MEASUREMENTS AS OF DECEMBER 31, 2010				
	LEVEL 1	LEVEL 2	LEVEL 3	TOTAL
Assets Measured at Fair Value:				
Recurring Basis				
Securities Available for Sale	\$ -	\$120,941,553	\$ -	\$120,941,553
Non-recurring Basis				
Collateral-dependent Impaired Loans, Net of Specific Reserves of \$0	\$ -	\$ -	\$ 1,148,000	\$ 1,148,000
Other Real Estate Owned, Net	\$ -	\$ -	\$ 811,631	\$ 811,631

Other real estate owned had a net carrying amount of \$751,631 and \$811,631 as of December 31, 2011 and 2010, respectively. These amounts reflect the outstanding balance of \$948,131, net of a valuation allowance of \$196,500 and \$136,500 at December 31, 2011 and 2010, respectively.

NOTE O – FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair value of a financial instrument is the amount at which the asset or obligation could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Fair value estimates are made at a specific point in time based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering

for sale at one time the entire holdings of a particular financial instrument. Because no market value exists for a significant portion of the financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature, involve uncertainties and matters of judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value estimates are based on financial instruments both on and off the balance sheet without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Additionally, tax consequences related to the realization of the unrealized gains and losses can have a potential effect on fair value estimates and have not been considered in many of the estimates.

The following methods and assumptions were used to estimate the fair value of significant financial instruments:

FINANCIAL ASSETS

The carrying amounts of cash, short term investments, due from customers on acceptances, and Bank acceptances outstanding are considered to approximate fair value. Short term investments include federal funds sold, securities purchased under agreements to resell, and interest bearing deposits with Banks. The fair values of investment securities, including available for sale, are generally based on quoted market

prices. The fair value of loans are estimated using a combination of techniques, including discounting estimated future cash flows and quoted market prices of similar instruments where available.

FINANCIAL LIABILITIES

The carrying amounts of deposit liabilities payable on demand, commercial paper, and other borrowed funds are considered to approximate fair value. For fixed maturity deposits, fair value is estimated by discounting estimated future cash flows using currently offered rates for deposits of similar remaining maturities. The fair value of long term debt is based on rates currently available to the Bank for debt with similar terms and remaining maturities.

OFF-BALANCE SHEET FINANCIAL INSTRUMENTS

The fair value of commitments to extend credit and standby letters of credit is estimated using the fees currently charged to enter into similar agreements. The fair value of these financial instruments is not material.

The estimated fair value of financial instruments at December 31, 2011 and 2010 are summarized as follows (dollar amounts in thousands):

	2011		2010	
	CARRYING AMOUNT	FAIR VALUE	CARRYING AMOUNT	FAIR VALUE
Financial Assets				
Cash and Due From Banks	\$ 33,627	\$ 33,627	\$ 21,258	\$ 21,258
Interest-Bearing Deposits	249	249	1,990	1,993
Investment Securities	130,793	130,793	120,942	120,942
Net Loans	38,201	37,814	48,424	48,714
Bank Owned Life Insurance	5,535	5,535	4,349	4,349
Accrued Interest Receivable	1,098	1,098	1,200	1,200
Financial Liabilities				
Deposits	\$168,504	\$168,365	\$171,130	\$170,838
Borrowings	20,000	20,000	14,000	14,000
Accrued Interest Payable	73	73	59	59

SAN DIEGO TRUST BANK TEAM

Executive Management

MICHAEL E. PERRY
*Chairman of the Board, President
& Chief Executive Officer*

TOBY RESCHAN
*Senior Executive Vice President
Chief Operating Officer*

JOE SIMMONS
*Executive Vice President
Chief Credit Officer*

NASRIN ROSTAMI
*Executive Vice President
Risk Management*

Board of Directors

MICHAEL E. PERRY
Chairman of the Board

MICHAEL A. MORTON
Vice Chairman of the Board

WILLIAM E. COLE

CHRISTOPHER J. COSEO

JAMES W. LEDWITH

TOBY RESCHAN

JAMES R. ST. JOHN

RICHARD H. WESSELINK

CLAUDETTE G. WILSON

Staff Members

KEDEST BERHANU
Vice President Operations

LAURA BLACK
Customer Service Rep.

MICHELE BROCHARD
Sr. Financial Services Rep.

JANESSA CAMACHO
Customer Service Rep.

TODD CHRISTENSEN
Accounting Assistant

JOAN FAUST
*Assistant Vice President
Customer Service Manager*

AMY FINK
Executive Assistant

SABRINA GARCIA
Customer Service Manager

CAROLINE GUDEL
Customer Service Rep.

STEPHANIE HELMUTH
Financial Services Rep.

JUDI IDES
*Vice President
Loan Administration*

JOHN JEFFRIES
*Senior Vice President
Chief Financial Officer*

MIRANDA KLASSEN
*Vice President
Business Development*

MARGIE MICHALEK
Customer Service Rep.

ALBERT MOTOLA
*Vice President &
Branch Manager*

BARBIE PICART
Sr. Customer Service Rep.

MARY PURVIANCE
*Senior Vice President &
Regional Manager*

MARCIA ROBINSON
Financial Services Manager

CHRISTINA RODRIGUEZ
Customer Service Rep.

FARIBA SEYSAN
*Assistant Vice President
Customer Service Manager*

RAYMOND SIMAS
*Senior Vice President &
Regional Manager*

JAMI STRONA
Vice President Operations

Directors Emeritus

LARRY L. WILLETTE
Chairman Emeritus

BRIAN GOWLAND
Vice Chairman Emeritus

DAN HERDE
Director Emeritus

SHAREHOLDER INFORMATION

Annual Meeting

May 17, 2012
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Investor Relations

San Diego Trust Bank common stock is traded on the Over-the-Counter Market under the symbol "SDBK".

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