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A N N U A L R E P O R T



## **Directors and Bank Executives**

### **Board of Directors:**

ALLAN W. ARENDSEE  
Chairman of the Board

RICHARD M. SANBORN  
President & CEO

RONALD A. BEDELL  
Director

LISA M. BETYAR  
Director

ROBERT DEPHILIPPIS  
Director

MARK I. GREENE  
Director

RICHARD S. LEVENSON  
Director

BRUCE A. NUNES  
Director

### **Executive Management:**

RICHARD M. SANBORN  
President & Chief Executive Officer

MARK A. NUGENT  
Executive Vice President & Chief Credit Officer

RONNIE R. ZIVANIC  
Executive Vice President & Chief Financial Officer

NICHOLAS W. ZILLGES  
Executive Vice President & Chief Administrative Officer



To our valued Shareholders:

Straight talk, both good and bad, and honesty! It's what we spoke about last year at the Annual Meeting, and what we will write with this year.

We are operating in an environment with unprecedented challenges. An economic recession that has been compared to the great depression; regulatory scrutiny, fees, and oversight more burdensome than ever; political pressure and regulation beyond belief; interest rates at their lowest levels in history; bank failures expected to be in the hundreds across the nation; and the possible nationalization of the nation's biggest banks. This is reality.

Yet, in the midst of this economic meltdown where the global financial system has faltered, we have succeeded! We are not so naive as to think we are out in the clear yet, and we know much more work needs to be done, and more losses are expected, but our progress and successes are evident and factual.

To begin with, we cut our operating loss in half in 2008. This was not an easy task given the Federal Reserve's interest rate cuts to zero. We continue to focus on increasing our net interest margin in spite of interest rate cuts, as it is the life blood of our revenue.

Our next success was the recapitalization of our Bank during the most difficult capital markets collapse in our history. We over-subscribed our private placement offering in the third quarter of 2008, raising \$4 million in new common equity. Of particular importance, the Board, along with the Management team, our friends and family invested more than \$2 million in our Bank. The Board and Management teams' commitment to the Bank is unwavering; we are fully invested and very focused on the Bank's success. With the offering complete, the Board and Management team now own close to 28% of our stock.

As a result of our successful capital raise, and an investment of \$1.8 million by the United States Treasury Department through the "TARP" Capital Purchase Program, our capital ratios at the end of 2008 were the second highest in San Diego County out of all 29 financial institutions that have been in business more than two years, and one of the highest in California. Our Total Risk Based Capital at December 31, 2008 stood at 21.95%, more than double the highest standard established by the FDIC. This capital will help us cushion our expected 2009 loss and allow us to expand and grow in 2010 and beyond.

As to the US Treasury Department's Preferred Stock investment in Seacoast, to be clear, we did not need the capital and this was not a bail out. The extra capital from the US Treasury allows us to further lend into the San Diego community, helping borrowers help our local economy. Where many banks are not lending, we are! Contrary to what Congress and the press may represent, we are using the TARP money for its intended purpose -- lending into and aiding the San Diego economy. We have earmarked our TARP funds for borrowers who intend to buy foreclosed properties in the area. This will help our local real estate market. Rest assured; we are focused in our lending practice.

Looking forward, we expect our problem loans to improve by the end of this year. We have also committed resources to drive our growth during 2009 with the addition of several business development officers to our team. These officers are developing new business for our Bank and, as a result, we achieved record growth by the end of 2008.

Although it is difficult to feel at ease in this market, we want you to know that your Board and Management team are dedicated to the Bank's success. We have confidence in the team we have assembled. We have confidence in our plan to weather the economic storm. And we have confidence our Bank will thrive in the years ahead.

Lastly, although it is difficult to watch the financial markets decline, please understand that we are taking a long-term approach to adding value to our franchise and we will always be committed to increasing shareholder value each and every year.

There is much more to share about what's going on with our Bank, and we hope you can attend the Annual Shareholders' Meeting where we will be discussing our plans in more detail. In the event you cannot attend, please feel free to contact us so we can answer your questions.

As always, we sincerely appreciate your confidence in us as expressed by your business and referrals. Your support will help us achieve our mutual goals. Thank you for your continued trust and investment in Seacoast Commerce Bank.



Allan W. Arendsee  
Chairman of the Board



Richard M. Sanborn  
President & Chief Executive Officer

Certain statements in this letter, including statements regarding the anticipated development and expansion of the Bank's business, and the intent, belief or current expectations of the Bank, its Directors and Officers are "forward-looking" statements (as such term is defined in the Private Securities Litigation Reform Act of 1995). Because such statements are subject to risks and uncertainties, actual results may differ materially from those expressed or implied by such forward-looking statements. These risks and uncertainties include, but are not limited to, risks related to the local and national economy, the Bank's performance and implementation of its business plan, loan performance, interest rates and regulatory matters.



## INDEPENDENT AUDITORS' REPORT

Board of Directors and Shareholders of  
Seacoast Commerce Bank

We have audited the accompanying consolidated statements of financial condition of Seacoast Commerce Bank as of December 31, 2008 and 2007 and the related statements of operations, 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 audit 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Seacoast Commerce Bank as of December 31, 2008 and 2007 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  
March 6, 2009

**SEACOAST COMMERCE BANK**

**CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION**  
**December 31, 2008 and 2007**

**ASSETS**

	2008	2007
Cash and Due from Banks	\$ 1,054,281	\$ 1,507,156
Federal Funds Sold	9,580,000	735,000
Interest-Bearing Deposits in Other Banks	4,326,000	-
<b>TOTAL CASH AND CASH EQUIVALENTS</b>	<b>14,960,281</b>	<b>2,242,156</b>
Time Deposits in Other Banks	194,000	-
Investment Securities Available for Sale	4,755,076	5,780,242
Loans:		
Real Estate - Construction	6,345,032	14,683,786
Real Estate - Other	44,506,847	36,108,170
Commercial	9,482,519	6,568,679
Consumer	471,451	696,940
<b>TOTAL LOANS</b>	<b>60,805,849</b>	<b>58,057,575</b>
Net Deferred Loan Costs	( 177,725)	( 99,613)
Allowance for Loan Losses	( 1,262,360)	( 1,282,373)
<b>NET LOANS</b>	<b>59,365,764</b>	<b>56,675,589</b>
Premises and Equipment	478,215	565,470
Federal Home Loan Bank and Other Stock - at Cost	880,000	427,500
Other Real Estate Owned	-	829,156
Accrued Interest and Other Assets	507,006	621,404
	<b>\$ 81,140,342</b>	<b>\$ 67,141,517</b>

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

**SEACOAST COMMERCE BANK**

**CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION**  
**December 31, 2008 and 2007**

**LIABILITIES AND SHAREHOLDERS' EQUITY**

	2008	2007
Deposits:		
Noninterest-Bearing Demand	\$ 9,992,488	\$ 8,108,213
Savings, NOW and Money Market Accounts	15,983,827	8,270,039
Time Deposits Under \$100,000	22,004,612	18,336,476
Time Deposits \$100,000 and Over	10,320,518	17,716,999
<b>TOTAL DEPOSITS</b>	58,301,445	52,431,727
Other Borrowings	9,000,000	5,000,000
Accrued Interest and Other Liabilities	619,658	557,347
<b>TOTAL LIABILITIES</b>	67,921,103	57,989,074
Commitments and Contingencies - Notes D and J	-	-
Shareholders' Equity:		
Preferred Stock - 10,000,000 Shares Authorized, \$1,000 Par Value - 1,890 Shares Issued and Outstanding in 2008	1,770,592	-
Common Stock - 10,000,000 Shares Authorized, No Par Value - Shares Issued and Outstanding, 2,136,912 in 2008 and 1,496,912 in 2007	18,870,282	15,127,087
Additional Paid-in Capital	372,561	252,003
Accumulated Deficit	( 7,820,008)	( 6,211,590)
Accumulated Other Comprehensive Income - Unrecognized Gain (Loss) on Available-for-Sale Securities	25,812	( 15,057)
<b>TOTAL SHAREHOLDERS' EQUITY</b>	13,219,239	9,152,443
	\$ 81,140,342	\$ 67,141,517

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

**SEACOAST COMMERCE BANK**

**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**For the Years Ended December 31, 2008 and 2007**

	2008	2007
<b>INTEREST INCOME</b>		
Interest and Fees on Loans	\$ 4,551,983	\$ 4,399,119
Interest on Investment Securities	212,552	236,258
Other Interest Income	99,752	363,856
<b>TOTAL INTEREST INCOME</b>	<b>4,864,287</b>	<b>4,999,233</b>
<b>INTEREST EXPENSE</b>		
Interest on Savings Deposits, NOW and Money Market Accounts	209,933	245,156
Interest on Time Deposits	1,412,066	1,812,378
Interest on Borrowings	278,895	50,365
<b>TOTAL INTEREST EXPENSE</b>	<b>1,900,894</b>	<b>2,107,899</b>
<b>NET INTEREST INCOME</b>	<b>2,963,393</b>	<b>2,891,334</b>
Provision for Loan Losses	1,774,900	2,498,645
<b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>	<b>1,188,493</b>	<b>392,689</b>
<b>NONINTEREST INCOME</b>		
Service Charges, Fees and Other Income	262,521	146,862
Gain on Sale of Other Real Estate Owned	343,759	-
Gain on Sale of Loans	520,227	214,336
Servicing Income on Loans Sold	16,079	18,532
	<b>1,142,586</b>	<b>379,730</b>
<b>NONINTEREST EXPENSE</b>		
Salaries and Employee Benefits	2,048,966	2,271,926
Occupancy and Equipment Expenses	626,452	773,281
Other Expenses	1,261,887	1,274,550
	<b>3,937,305</b>	<b>4,319,757</b>
<b>LOSS BEFORE INCOME TAXES</b>	<b>( 1,606,226)</b>	<b>( 3,547,338)</b>
Income Taxes	1,600	800
<b>NET LOSS</b>	<b>\$ ( 1,607,826)</b>	<b>\$ ( 3,548,138)</b>
<b>NET LOSS PER SHARE - BASIC</b>	<b>\$ ( 0.79)</b>	<b>\$ ( 2.37)</b>

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

**SEACOAST COMMERCE BANK**

**CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY**  
**For the Years Ended December 31, 2008 and 2007**

	Preferred Stock		Common Stock		Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total
	Number of Shares	Amount	Number of Shares	Amount				
<b>Balance at January 1, 2007</b>	-	\$ -	1,496,912	\$ 15,127,087	\$ 90,358	\$( 2,663,452)	\$( 87,078)	\$ 12,466,915
Stock-based Compensation					161,645			161,645
<b>Comprehensive Income:</b>								
Net Loss						( 3,548,138)		( 3,548,138)
Unrealized Gain on Securities Available for Sale							72,021	72,021
		<u>72,021</u>						
<b>Total Comprehensive Income</b>								<u><u>\$( 3,476,117)</u></u>
<b>Balance at December 31, 2007</b>	-	-	1,496,912	15,127,087	252,003	( 6,211,590)	( 15,057)	9,152,443
Stock-based Compensation					120,558			120,558
Issuance of Preferred Stock, Net of Costs of \$30,000	1,890	1,770,000						1,770,000
Accretion of Discount on Preferred Stock		592				( 592)		-
Proceeds from the Sale of Common Stock, Net of Costs of \$287,659			640,000	3,743,195				3,743,195
<b>Comprehensive Income:</b>								
Net Loss						( 1,607,826)		( 1,607,826)
Unrealized Gain on Securities Available for Sale							40,869	40,869
		<u>40,869</u>						
<b>Total Comprehensive Income</b>								<u><u>\$( 1,566,957)</u></u>
<b>Balance at December 31, 2008</b>	<u>1,890</u>	<u>\$ 1,770,592</u>	<u>2,136,912</u>	<u>\$ 18,870,282</u>	<u>\$ 372,561</u>	<u>\$ (7,820,008)</u>	<u>\$ 25,812</u>	<u>\$ 13,219,239</u>

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

**SEACOAST COMMERCE BANK**

**CONSOLIDATED STATEMENTS OF CASH FLOWS  
For the Years Ended December 31, 2008 and 2007**

	2008	2007
<b>OPERATING ACTIVITIES</b>		
Net Loss	\$( 1,607,826)	\$( 3,548,138)
Adjustments to Reconcile Net Loss to Net Cash		
Provided (Used) by Operating Activities:		
Depreciation and Amortization	118,682	176,588
Stock-based Compensation	120,558	161,645
Gain on Sale of OREO	( 343,759)	-
Gain on Sale of Loans	( 520,227)	( 214,336)
Provision for Loan Losses	1,774,900	2,498,645
Other Items	510,103	72,040
<b>NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES</b>	<b>52,431</b>	<b>( 853,556)</b>
<b>INVESTING ACTIVITIES</b>		
Purchase of Interest-Bearing Deposits	( 194,000)	-
Purchase of FHLB and Other Equity Stock	( 435,500)	( 41,400)
Purchase of Available-for-Sale Securities	-	( 4,195,542)
Proceeds from Maturities of Available-for-Sale Securities	-	500,000
Principal Paydowns of Available-for-Sale Securities	1,059,400	770,621
Net Increase in Loans	( 16,087,690)	( 17,200,564)
Proceeds from the Sale of Other Real Estate Owned	3,678,403	-
Proceeds from Loans Sold	9,293,595	3,869,848
Purchases of Premises and Equipment	( 31,427)	( 517,049)
<b>NET CASH USED BY INVESTING ACTIVITIES</b>	<b>( 2,717,219)</b>	<b>( 16,814,086)</b>
<b>FINANCING ACTIVITIES</b>		
Net Increase in Demand Deposits and Savings Accounts	9,598,063	1,006,248
Net Increase (Decrease) in Time Deposits	( 3,728,345)	3,491,831
Net Change in Other Borrowings	4,000,000	5,000,000
Proceeds from Issuance of Preferred Stock, Net	1,770,000	-
Proceeds from Sale of Common Stock, Net	3,743,195	-
<b>NET CASH PROVIDED BY FINANCING ACTIVITIES</b>	<b>15,382,913</b>	<b>9,498,079</b>
<b>INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>12,718,125</b>	<b>( 8,169,563)</b>
Cash and Cash Equivalents at Beginning of Period	2,242,156	10,411,719
<b>CASH AND CASH EQUIVALENTS AT END OF YEAR</b>	<b>\$ 14,960,281</b>	<b>\$ 2,242,156</b>
<b>Supplemental Disclosures of Cash Flow Information:</b>		
Interest Paid	\$ 1,942,674	\$ 2,093,313
Taxes Paid	\$ 1,600	\$ 800
Transfer of Loans to Other Real Estate Owned	\$ 2,849,247	\$ 829,156

# SEACOAST COMMERCE BANK

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2008 and 2007

### NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### Nature of Operations

The Bank has been organized as a single operating segment and operates one full-service office in Chula Vista, California. During 2008, the Bank formed SCB Assets LLC, a California limited liability company, to take ownership in and manage certain investments on behalf of the Bank. During 2007, the Bank formed SCB Properties LLC, a Delaware limited liability company, to take ownership in and manage other real estate owned on behalf of the Bank. The operations of SCB Assets LLC and SCB Properties LLC have been consolidated with the operations of the Bank and material intercompany transactions have been eliminated.

The Bank's primary source of revenue is providing loans to customers, who are predominately small and middle-market businesses and individuals. The Bank operates under a state charter and provides full banking services. As a state bank, the Bank is subject to regulation by the California Department of Financial Institutions ("DFI") and the Federal Deposit Insurance Corporation ("FDIC"). The accounting and reporting policies of the Bank are in accordance with accounting principles generally accepted in the United States of America and conform to practices within the banking industry. The following are descriptions of the more significant of those policies.

#### 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.

The determination of the adequacy of the allowance for loan losses is based on estimates that are particularly susceptible to significant changes in the economic environment and market conditions. In connection with the determination of the estimated losses on loans, management obtains independent appraisals for significant collateral. The Bank's loans are generally secured by specific items of collateral including real property, consumer assets and business assets.

While management uses available information to recognize losses on loans, further reductions in the carrying amounts of loans may be necessary based on changes in local economic conditions. Because of these factors, it is reasonably possible that the estimated losses on loans may change materially in the near term. However, the amount of the changes that is reasonably possible cannot be estimated.

#### Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash, due from banks, interest-bearing deposits in other banks with maturities under ninety days and federal funds sold. Generally, federal funds are sold for one-day periods.

## SEACOAST COMMERCE BANK

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS December 31, 2008 and 2007

#### NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

##### 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 was in compliance with all reserve requirements as of December 31, 2008.

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 using the specific identification method.

Declines in the fair value of individual held-to-maturity and available-for-sale securities below their cost that are other-than-temporary result in write-downs of the individual securities to their fair value. The related write-downs are included in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers: the length of time and the extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer, and the intent and ability of the Bank to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

##### 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 periodically evaluated for impairment based on the ultimate recovery of par value. Both cash and stock dividends are reported as income. The Bank's investment in FHLB stock was \$440,000 at December 31, 2008 and \$237,500 at December 31, 2007.

## SEACOAST COMMERCE BANK

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS December 31, 2008 and 2007

#### NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

##### 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 capitalized and recognized as an adjustment of the yield of the related loan. Amortization of deferred loan fees is discontinued when a loan is placed on nonaccrual status.

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 based on the contractual terms of the loan or when, in the opinion of management, there is reasonable doubt as to collectibility. 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.

The Bank considers a loan to be impaired when it is probable that the Bank will be unable to collect all amounts due (principal and interest) according to the contractual terms of the loan agreement. 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 for which foreclosure is probable 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.

The Bank has adopted Statement of Financial Accounting Standard ("SFAS") No. 140, "*Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*," as amended by SFAS No. 156, "*Accounting for Servicing of Financial Assets*." These Statements provide accounting and reporting standards for transfers and servicing of financial assets and extinguishments of liabilities. Under this Statement, after a transfer of financial assets, an entity recognizes the financial and servicing assets it controls and liabilities it has incurred, derecognizes financial assets when control has been surrendered, and derecognizes liabilities when extinguished.

## SEACOAST COMMERCE BANK

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS December 31, 2008 and 2007

#### NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

##### Loan Sales and Servicing of Financial Assets

The Bank originates SBA and USDA loans for sale in the secondary market. Servicing rights are recognized separately when they are acquired through sale of loans. Servicing rights are initially recorded at fair value with the income statement effect recorded in gain on sale of loans. Fair value is based on a valuation model that calculates the present value of estimated future cash flows from the servicing assets. The valuation model uses assumptions that market participants would use in estimating cash flows from servicing assets, such as the cost to service, discount rates and prepayment speeds. The Bank compares the valuation model inputs and results to published industry data in order to validate the model results and assumptions. Servicing assets are subsequently measured using the amortization method which requires servicing rights to be amortized into noninterest income in proportion to, and over the period of, the estimated future net servicing income of the underlying loans.

Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to the carrying amount. Impairment is determined by stratifying rights into groupings based on predominant risk characteristics, such as interest rate, loan type and investor type. For purposes of measuring impairment, the Bank has identified each servicing asset with the underlying loan being serviced. A valuation allowance is recorded where the fair value is below the carrying amount of the asset. If the Bank later determines that all or a portion of the impairment no longer exists for a particular grouping, a reduction of the allowance may be recorded as an increase in income. The fair values of servicing rights are subject to significant fluctuations as a result of changes in estimated and actual prepayment speeds and changes in the discount rates.

Servicing fee income which is reported on the income statement as servicing income is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal and recorded as income when earned. The amortization of servicing rights and changes in the valuation allowance are netted against loan servicing income.

##### Allowance for Loan Losses

The Bank maintains an allowance for loan losses at an amount that, in management's judgment, should be adequate to absorb inherent losses on existing loans. The allowance for loan losses is increased by charging a provision to operations and decreased by charge-offs, net of recoveries. Management's evaluation of the adequacy of the allowance is based on a review of known and inherent risks in the loan portfolio, including adverse circumstances that may affect the ability of the borrower to repay interest and or principal, the estimated value of collateral, the levels and trends of delinquencies, charge-offs and the risk ratings of the various loan categories. Such factors as the level and trend of interest rates and the condition of the national and local economies are also considered.

## SEACOAST COMMERCE BANK

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS December 31, 2008 and 2007

#### NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

##### 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

Real estate acquired by foreclosure or deed in lieu of foreclosure is recorded at fair value at the date of foreclosure, establishing a new cost basis by a charge to the allowance for loan losses, if necessary. Other real estate owned is carried at the lower of the Bank's carrying value of the property or its fair value, less estimated carrying costs and costs of disposition. Fair value is based on current appraisals less estimated selling costs. Any subsequent write-downs are charged against operating expenses and recognized as a valuation allowance. Operating expenses of such properties, net of related income, and gains and losses on their disposition are included in other operating expenses.

##### Advertising Costs

The Bank expenses the costs of advertising in the period incurred.

##### Income Taxes

Deferred income taxes are computed using the asset and liability method, which recognizes a liability or asset representing the tax effects, based on current tax law, of future deductible or taxable amounts attributable to events that have been recognized in the consolidated financial statements. A valuation allowance is established to reduce the deferred tax asset to the level at which it is "more likely than not" that the tax asset or benefits will be realized. Realization of tax benefits of deductible temporary differences and operating loss carryforwards depends on having sufficient taxable income of an appropriate character within the carryforward periods.

The Bank has adopted Financial Accounting Standards Interpretation No. 48 ("FIN 48"), "*Accounting for Uncertainty in Income Taxes*." FIN 48 clarifies the accounting for uncertainty in tax positions taken or expected to be taken on a tax return and provides that the tax effects from an uncertain tax position can be 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. Management believes that all tax positions taken to date are highly certain and, accordingly, no accounting adjustment has been made to the financial statements. Interest and penalties related to uncertain tax positions are recorded as part of income tax expense.

## SEACOAST COMMERCE BANK

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS December 31, 2008 and 2007

#### NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

##### 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.

##### Comprehensive Income

SFAS No. 130, "*Reporting Comprehensive Income*," requires the disclosure of comprehensive income and its components. Changes in unrealized gain (loss) on available-for-sale securities are the only component of accumulated other comprehensive income for the Bank.

##### 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. In 2008 and 2007, the Bank incurred a net loss and common stock equivalents were antidilutive.

##### Stock-Based Compensation

The Bank has adopted SFAS No. 123(R) "*Share-Based Payment*." This statement generally requires entities to recognize the cost of employee services received in exchange for awards of stock options, or other equity instruments, based on the grant-date fair value of those awards. This cost is recognized over the period which an employee is required to provide services in exchange for the award, generally the vesting period.

##### Fair Value Measurement

Effective January 1, 2008, the Bank adopted SFAS No. 157, *Fair Value Measurements*. This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. This Statement establishes a fair value hierarchy about the assumptions used to measure fair value and clarifies assumptions about risk and the effect of a restriction on the sale or use of an asset. The impact of adoption of SFAS No. 157 is not material.

In February 2008, the FASB issued Staff Position (FSP) 157-2, *Effective Date of FASB Statement no. 157*. This FSP delays the effective date of SFAS 157 for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value on a recurring basis (at least annually) for fiscal years beginning after November 15, 2008.

## SEACOAST COMMERCE BANK

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS December 31, 2008 and 2007

#### NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

##### Fair Value Measurement - Continued

In February 2007, the FASB issued Statement 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. The standard provides companies with an option to report selected financial assets and liabilities at fair value and establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. The new standard was effective for the Bank on January 1, 2008. The Bank did not elect the fair value option for any financial assets or financial liabilities as of January 1, 2008.

SFAS No. 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an 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.

Statement 157 also 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. The standard describes three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) or 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 L for more information and disclosures relating to the Bank's fair value measurements.

##### Reclassifications

Certain reclassifications have been made in the 2007 financial statements to conform to the presentation used in 2008. These reclassifications had no impact of the Bank's previously reported financial statements.

**SEACOAST COMMERCE BANK**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2008 and 2007**

**NOTE B - INVESTMENT SECURITIES**

Debt and equity securities have been classified in the statements of condition according to management's intent. The carrying amount of available-for-sale securities and their approximate fair values at December 31 were as follows:

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
December 31, 2008:				
U.S. Government Agency Securities	\$ 1,343,935	\$ -	\$( 18,502)	\$ 1,325,433
Mortgage-backed Securities	<u>3,385,329</u>	<u>45,775</u>	<u>( 1,461)</u>	<u>3,429,643</u>
	<u>\$ 4,729,264</u>	<u>\$ 45,775</u>	<u>\$( 19,963)</u>	<u>\$ 4,755,076</u>
December 31, 2007:				
U.S. Government Agency Securities	\$ 2,015,184	\$ 110	\$( 9,065)	\$ 2,006,229
Mortgage-backed Securities	<u>3,780,115</u>	<u>27,493</u>	<u>( 33,595)</u>	<u>3,774,013</u>
	<u>\$ 5,795,299</u>	<u>\$ 27,603</u>	<u>\$( 42,660)</u>	<u>\$ 5,780,242</u>

Investment securities carried at \$4,729,264 and \$5,777,546 at December 31, 2008 and 2007, respectively, were pledged to secure the borrowing arrangement with the Federal Home Loan Bank described in Note G.

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

	<u>Available-for-Sale Securities</u>	
	<u>Amortized Cost</u>	<u>Fair Value</u>
Due in One Year or Less	\$ 1,542,307	\$ 1,523,157
Due from One Year to Five Years	1,338,211	1,356,532
Due from Five to Ten Years	-	-
Due after Ten Years	<u>1,848,746</u>	<u>1,875,387</u>
	<u>\$ 4,729,264</u>	<u>\$ 4,755,076</u>

The Bank did not sell any of its available-for-sale securities in 2008 and 2007.

**SEACOAST COMMERCE BANK**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2008 and 2007**

**NOTE B - INVESTMENT SECURITIES - Continued**

The unrealized losses in available-for-sale securities as of December 31, 2008 and 2007 with continuous losses present for less than twelve months and twelve months or more and their fair value is summarized below:

	<u>Less than Twelve Months</u>		<u>Over Twelve Months</u>		<u>Total</u>	
	<u>Unrealized losses</u>	<u>Estimated fair value</u>	<u>Unrealized losses</u>	<u>Estimated fair value</u>	<u>Unrealized losses</u>	<u>Estimated fair value</u>
<u>December 31, 2008</u>						
U.S. Government						
Agency Securities	\$( 493)	\$ 48,762	\$( 18,010)	\$1,276,671	\$( 18,503)	\$1,325,433
Mortgage-backed Securities	-	-	( 1,460)	499,559	( 1,460)	499,559
	<u>\$( 493)</u>	<u>\$ 48,762</u>	<u>\$( 19,470)</u>	<u>\$1,776,230</u>	<u>\$( 19,963)</u>	<u>\$1,824,992</u>
<u>December 31, 2007</u>						
U.S. Government						
Agency Securities	\$( 9,065)	\$1,954,708	\$ -	\$ -	\$( 9,065)	\$1,954,708
Mortgage-backed Securities	-	-	\$( 33,595)	\$1,799,519	( 33,595)	1,799,519
	<u>\$( 9,065)</u>	<u>\$1,954,708</u>	<u>\$( 33,595)</u>	<u>\$1,799,519</u>	<u>\$( 42,660)</u>	<u>\$3,754,227</u>

As of December 31, 2008, the Bank had eleven investment securities where estimated fair value had declined 1.1% from the Bank's amortized cost. Management evaluates investment securities for other-than-temporary impairment taking into consideration the extent and length of time the fair value has been less than cost, the financial condition of the issuer and whether the Bank has the intent and ability to retain the investment for a period of time sufficient to allow for any anticipated recovery in fair value. As of December 31, 2008, no declines are deemed to be other than temporary.

As of December 31, 2007, the Bank had fifteen investment securities where estimated fair value had declined 1.1% from the Bank's amortized cost.

**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.

**SEACOAST COMMERCE BANK**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2008 and 2007**

**NOTE C - LOANS - Continued**

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

	2008	2007
Balance at Beginning of Year	\$ 1,282,373	\$ 570,034
Additions to the Allowance Charged to Expense	1,774,900	2,498,645
Recoveries on Loans Charged Off	143,775	29,930
	3,201,048	3,098,609
Less Loans Charged Off	( 1,938,688)	( 1,816,236)
	\$ 1,262,360	\$ 1,282,373

The following is a summary of the investment in impaired loans, the related allowance for loan losses, and income recognized thereon.

	Total Balance	Guaranteed Balance	Unguaranteed Balance	Allocated Allowance
<b>December 31, 2008:</b>				
Loans with no Allocated Allowance	\$ 3,774,442	\$( 861,122)	\$ 2,913,320	\$ -
Loans with Allocated Allowance	64,976	-	64,976	13,745
	\$ 3,839,418	\$( 861,122)	\$ 2,978,296	\$ 13,745
<b>December 31, 2007:</b>				
Loans with no Allocated Allowance	\$ -	\$ -	\$ -	\$ -
Loans with Allocated Allowance	601,420	( 178,065)	423,355	63,503
	\$ 601,420	\$( 178,065)	\$ 423,355	\$ 63,503
			2008	2007
Average of Individually Impaired Loans During the Year			\$ 4,111,500	\$ 1,845,000
Interest Income Recognized for Cash Payments			\$ -	\$ -

**SEACOAST COMMERCE BANK**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2008 and 2007**

**NOTE C - LOANS - Continued**

The information pertaining to nonaccrual and past due loans as of December 31 is as follow:

	<u>Total Balance</u>	<u>Guaranteed Balance</u>	<u>Unguaranteed Balance</u>
<b>December 31, 2008:</b>			
Past Due Over 90 Days Still on Accrual	\$ -	\$ -	\$ -
Nonaccrual Loans	\$ 3,839,418	\$( 861,122)	\$ 2,978,296
<b>December 31, 2007:</b>			
Past Due Over 90 Days Still on Accrual	\$ -	\$ -	\$ -
Nonaccrual Loans	\$ 601,420	\$( 178,065)	\$ 423,355

The Bank also originates loans that may be sold to institutional investors. Serviced loans are not carried on the Bank's statement of financial condition. Gain on sale of loans amounted to approximately \$520,000 and \$214,000 in 2008 and 2007, respectively. At December 31, 2008 and 2007, the Bank was servicing approximately \$12,780,000 and \$5,006,000 in loans previously sold.

**NOTE D - PREMISES AND EQUIPMENT**

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

	<u>2008</u>	<u>2007</u>
Furniture, Fixtures, and Equipment	\$ 235,558	\$ 232,904
Computer Equipment	286,519	265,968
Leasehold Improvements	602,240	594,019
	<u>1,124,317</u>	<u>1,092,891</u>
Less Accumulated Depreciation and Amortization	( 646,102)	( 527,421)
	<u>\$ 478,215</u>	<u>\$ 565,470</u>

## SEACOAST COMMERCE BANK

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS December 31, 2008 and 2007

#### NOTE D - PREMISES AND EQUIPMENT - Continued

The Bank has entered into leases for its bank branch and headquarters in Chula Vista under a lease which expires on January 31, 2017, and provides for two five-year options to renew at the then current market rate. The lease includes a provision for periodic rent increases. The Bank is responsible for its pro rata share of common area expenses including maintenance, taxes and insurance. The Bank has also entered into a lease for a second branch in the Eastlake area of Chula Vista which expires on October 31, 2014 and provides for one five-year option to renew at the then current market rate. The lease includes a provision for periodic rent increases. The Bank is responsible for its pro rata common area expenses including maintenance, taxes and insurance. The Bank has decided not to utilize the Eastlake area location as a second branch and has currently listed the location for sublease.

At December 31, 2008, the future lease rental payable under noncancellable operating lease commitments for the Bank's main office and branch office was as follows:

2009	\$ 364,243
2010	384,018
2011	398,859
2012	414,210
2013	430,361
Thereafter	<u>1,159,174</u>
	<u>\$ 3,150,865</u>

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 was approximately \$421,000 and \$418,000 for the periods ended December 31, 2008 and 2007, respectively.

#### NOTE E - DEPOSITS

At December 31, 2008, the scheduled maturities of time deposits were approximately as follows:

Due in One Year or Less	\$ 26,559,000
Due from One to Three Years	<u>5,766,000</u>
	<u>\$ 32,325,000</u>

**SEACOAST COMMERCE BANK**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2008 and 2007**

**NOTE F - INCOME TAXES**

Income taxes payable for the periods ended December 31, 2008 and 2007 were the minimum franchise tax for the State of California due to operating losses and operating loss carryovers. The tax benefit related to the operating losses incurred during the periods ended December 31, 2008 and 2007 were not recognized, as realization of the benefit is dependent upon future income.

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 accounts recognized in the accompanying statements of financial condition at December 31:

	2008	2007
Deferred Tax Assets:		
Pre-Opening Expenses	\$ -	\$ 28,000
Operating Loss Carryforwards	2,916,000	2,253,000
Allowance for Loan Losses Due to Tax Limitations	106,000	282,000
Depreciation Differences	74,000	67,000
Stock-Based Compensation	78,000	53,000
Accrual to Cash	72,000	-
Other Items	54,000	20,000
	3,300,000	2,703,000
 Valuation Allowance	 ( 3,243,000)	 ( 2,652,000)
 Deferred Tax Liabilities:		
Other Items	( 57,000)	( 51,000)
	( 57,000)	( 51,000)
 Net Deferred Tax Assets	 <u>\$ -</u>	 <u>\$ -</u>

The valuation allowance was established because the Bank has not reported earnings sufficient enough to support the recognition of the deferred tax assets. The Bank has net operating loss carryforwards of approximately \$6.8 million for federal income and \$8.2 million for California franchise tax purposes. Federal net operating loss carryforwards, to the extent not used, will expire in 2028. California net operating loss carryforwards, to the extent not used will expire in 2028.

The Company is subject to federal and California income tax. Federal income tax returns for the years ended December 31, 2007, 2006 and 2005 are open to audit by the federal authorities and California returns for the years ended December 31, 2007, 2006, 2005 and 2004 are open to audit by state authorities.

**SEACOAST COMMERCE BANK**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2008 and 2007**

**NOTE G - BORROWING ARRANGEMENTS**

The Bank may borrow up to \$4,400,000 overnight on an unsecured basis from two of its correspondent banks. As of December 31, 2008 and 2007, no amounts were outstanding under these arrangements.

The Bank also has a line of credit with the Federal Home Loan Bank secured by certain of its investments and loans. As of December 31, 2008, this line has total financing availability of approximately \$12 million and is collateralized by investment securities of approximately \$4.4 million and loans of approximately \$7.6 million. As of December 31, 2008, the Bank had the following outstanding advances from the FHLB under this line:

<u>Amount</u>	<u>Interest Rate</u>	<u>Maturity Date</u>
\$ 3,000,000	3.53%	3/30/2009
1,000,000	3.09%	5/13/2010
1,000,000	3.09%	5/17/2010
2,602,000	3.55%	6/28/2010
<u>1,398,000</u>	3.45%	6/28/2010
<u><u>\$ 9,000,000</u></u>		

**NOTE H - OTHER EXPENSES**

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

	<u>2008</u>	<u>2007</u>
Marketing and Business Promotion	\$ 118,323	\$ 110,279
Professional Fees	285,252	186,937
Data Processing	259,956	305,112
Directors Expenses and Stock-based Compensation	19,650	128,142
Office Expenses	103,988	88,370
Correspondent Bank Charges	39,367	21,854
Regulatory Assessments	135,377	63,574
Corporate Insurances	51,471	76,654
Other Expenses	<u>248,503</u>	<u>293,628</u>
	<u><u>\$ 1,261,887</u></u>	<u><u>\$ 1,274,550</u></u>

## SEACOAST COMMERCE BANK

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS December 31, 2008 and 2007

#### NOTE I - RELATED PARTY TRANSACTIONS

In the ordinary course of business, the Bank may grant loans to certain officers and directors and the companies with which they are associated. In the Bank's opinion, all loans and loan commitments to such parties will be made on substantially the same terms, including interest rates and collateral, as those prevailing at the time of comparable transactions with other persons. The balance of these loans outstanding at December 31, 2008 and 2007 was approximately \$712,000 and \$148,000, respectively.

Deposits from certain directors and their related interests with which they are associated, held by the Bank at December 31, 2008 and 2007, amounted to approximately \$1,271,000 and \$1,216,000, respectively.

#### 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 reflected 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, 2008 and 2007, the Bank had the following outstanding financial commitments whose contractual amount represents credit risk:

	<u>2008</u>	<u>2007</u>
Commitments to Extend Credit	\$ 6,777,000	\$ 11,439,000
Letters of Credit	<u>338,000</u>	<u>1,356,000</u>
	<u>\$ 7,115,000</u>	<u>\$ 12,795,000</u>

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 majority of the Bank's commitments to extend credit and standby letters of credit are secured by real estate.

## SEACOAST COMMERCE BANK

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS December 31, 2008 and 2007

#### NOTE K - STOCK OPTION PLAN

The Bank adopted the Seacoast Commerce Bank 2008 Omnibus Equity Incentive Plan (“2008 Plan”) on November 19, 2008. The terms of the 2008 Plan state that officers and key employees may be granted restricted stock, nonqualified and incentive stock options. Directors and other consultants, who are not also an officer or employee, may not be granted incentive stock options. The 2008 Plan provides for options to purchase up to 305,000 shares of common stock at a price not less than 100% 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. The 2008 Plan provides for accelerated vesting if there is a change of control, as defined in the 2008 Plan. There have been no grants under the 2008 Plan as of December 31, 2008. The 2008 Plan will be submitted for approval by the Bank’s shareholders at the 2009 Annual Shareholder’s Meeting.

The Bank’s 2002 Stock Plan was approved by its shareholders on September 25, 2003. Under the terms of the 2002 Stock Plan, officers and key employees may be granted both nonqualified and incentive stock options. Directors and other consultants, who are not also an officer or employee, may only be granted nonqualified stock options. The Plan provided for options to purchase 449,000 shares of common stock at a price not less than 100% 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 and generally vest between four and five years. The Plan provided for accelerated vesting if there is a change of control, as defined in the Plan. The Bank recognized stock-based compensation costs of \$120,558 and \$161,645 in 2008 and 2007, respectively. The 2002 Stock Option Plan was terminated on November 19, 2008, although all the outstanding stock options remain valid in accordance with their terms.

The fair value of each option grant was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions presented below:

	<u>2008</u>	<u>2007</u>
Expected Volatility	23.00%	23.00%
Expected Term	6.43 Years	6.39 Years
Expected Dividends	None	None
Risk Free Rate	3.33%	3.81%
Weighted-Average Grant Date Fair Value	\$ 2.24	\$ 3.50

Since the Bank has a limited amount of historical stock activity, the expected volatility is based on the historical volatility of similar banks that have a longer trading history. The expected term represents the estimated average period of time that the options remain outstanding. Since the Bank does not have sufficient historical data on the exercise of stock options, the expected term is based on the “simplified” method that measures the expected term as the average of the vesting period and the contractual term. The risk free rate of return reflects the grant date interest rate offered for zero coupon U.S. Treasury bonds over the expected term of the options.

**SEACOAST COMMERCE BANK**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2008 and 2007**

**NOTE K - STOCK OPTION PLAN - Continued**

A summary of the status of the Bank's stock option plan as of December 31, 2008, and changes during the year ending thereon is presented below:

	<u>Shares</u>	<u>Weighted- Average Exercise Price</u>	<u>Weighted- Average Remaining Contractual Term</u>	<u>Aggregate Intrinsic Value</u>
Outstanding at Beginning of Year	320,944	\$ 9.99		
Granted	64,900	\$ 6.28		
Exercised	-	\$ -		
Forfeited or Expired	<u>( 50,155)</u>	\$ 10.74		
Outstanding at End of Year	<u>335,689</u>	<u>\$ 9.16</u>	<u>7.4 Years</u>	<u>None</u>
Options Exercisable	<u>145,188</u>	<u>\$ 9.94</u>	<u>5.5 Years</u>	<u>None</u>

No options were exercised in 2008 and 2007. As of December 31, 2008, there was \$532,000 of total unrecognized compensation cost related to the outstanding stock options that will be recognized over a weighted-average period of 2.5 years.

**NOTE L - 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 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 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. Fair value estimates for collateral-dependent impaired loans are obtained from real estate brokers or other third-party consultants (Level 3).

**SEACOAST COMMERCE BANK**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2008 and 2007**

**NOTE L - FAIR VALUE MEASUREMENT - Continued**

The following table provides the hierarchy and fair value for each major category of assets and liabilities measured at fair value at December 31, 2008:

	Fair Value Measurements Using			Total
	Level 1	Level 2	Level 3	
<b>Assets and liabilities measured at fair value on a recurring basis</b>				
Securities Available for Sale	\$ -	\$ 4,775,076	\$ -	\$ 4,775,076
<b>Assets measured at fair value on a non-recurring basis</b>				
Collateral-Dependent Impaired Loans, Net of Specific Reserves	\$ -	\$ -	\$ 2,819,186	\$ 2,819,186

Collateral-dependent impaired loans, which are measured for impairment using the fair value of the collateral, had a carrying value of \$2,819,186, with a specific reserve of \$0.

**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 can 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.

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, 2008, that the Bank meets all capital adequacy requirements to which it is subject.

**SEACOAST COMMERCE BANK**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2008 and 2007**

**NOTE M - REGULATORY MATTERS - Continued**

As of December 31, 2008, the most recent notification from 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
<b>As of December 31, 2008:</b>						
Total Capital (to Risk-Weighted Assets)	\$14,031	21.9%	\$ 5,099	8.0%	\$ 6,373	10.0%
Tier 1 Capital (to Risk-Weighted Assets)	\$13,229	20.7%	\$ 2,549	4.0%	\$ 3,824	6.0%
Tier 1 Capital (to Average Assets)	\$13,229	18.5%	\$ 2,854	4.0%	\$ 3,568	5.0%
<b>As of December 31, 2007:</b>						
Total Capital (to Risk-Weighted Assets)	\$ 9,863	17.9%	\$ 4,402	8.0%	\$ 5,502	10.0%
Tier 1 Capital (to Risk-Weighted Assets)	\$ 9,168	16.7%	\$ 2,201	4.0%	\$ 3,301	6.0%
Tier 1 Capital (to Average Assets)	\$ 9,168	13.3%	\$ 2,756	4.0%	\$ 3,444	5.0%

The California Financial Code provides that a bank may not make a 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 to the Bank's shareholders during the same period.

**NOTE N - SENIOR PREFERRED STOCK**

On December 23, 2008, the Bank entered into a Purchase Agreement with the United States Department of the Treasury (the "Treasury"), pursuant to which the Bank agreed to issue and sell 1,800 shares of the Bank's Fixed Rate Non-cumulative Perpetual Preferred Stock, Series A (the "Series A Preferred Stock") and 90 shares of Fixed Rate Non-cumulative Perpetual Preferred Stock, Series B (the "Series B Preferred Stock") for an aggregate purchase price of \$1,800,000 in cash less costs of \$30,000. The redemption of both Series A and Series B Preferred Stock will be \$1,890,000. The discount of \$120,000 will be accreted against retained earnings over the estimated five-year life of the Preferred Stock, reducing the reported income available for common shareholders.

## SEACOAST COMMERCE BANK

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS December 31, 2008 and 2007

#### NOTE N - SENIOR PREFERRED STOCK - Continued

The Series A Preferred Stock qualifies as Tier 1 capital and pays non-cumulative dividends at a rate of 5% per annum for the first five years and 9% per annum thereafter. The Series A Preferred Stock may be redeemed by the Bank after three years. Prior to the end of three years, the Series A Preferred Stock may be redeemed only with the proceeds from the sale of qualifying equity securities of the Bank. The Series B Preferred Stock also qualifies as Tier 1 capital and pays non-cumulative dividends at a rate of 9% per annum. The Series B Preferred Stock may only be redeemed after all of the Series A Preferred Stock has been redeemed. For as long as any Preferred Stock is outstanding and held by the Treasury, no dividends may be declared on common shares.

In the Purchase Agreement, the Bank agreed that, until such time as the Treasury ceases to own any debt or equity securities of the Bank acquired pursuant to the Purchase Agreement, the Bank will take all necessary action to ensure that its benefit plans with respect to its senior executive officers comply with Section 111(b) of the Emergency Economic Stabilization Act of 2008 (the "EESA"), as implemented by any guidance or regulation under the EESA that has been issued and is in effect as of the date of the issuance of the Preferred Stock, and has agreed to not adopt any benefit plans with respect to, or which covers, its senior executive officers that do not comply with the EESA, and the applicable executives have consented to the foregoing.

#### NOTE O - WARRANTS

In connection with the Bank's 2008 stock offering, the Bank issued one warrant to purchase an additional one share of common stock for each four shares purchased. These warrants may be exercised at any time from the date of issuance through December 31, 2009 for \$6.88 per share, from January 1, 2010 through December 31, 2010, for \$7.50 per share and from January 1, 2011 through December 31, 2011, for \$8.13 per share thereafter. As of December 31, 2008 there were 160,000 of these warrants outstanding.

In connection with the Bank's 2006 stock offering, the Bank issued one warrant to purchase an additional one share of common stock for each four shares purchased. These warrants may be exercised at any time from the date of issuance through September 30, 2009, subject to the right of the Board of Directors of the Bank, in its sole discretion, to extend the exercise period of the warrants. The exercise price for these warrants is \$12.65 per share. As of December 31, 2008 there were 140,478 of these warrants outstanding.

**Annual Meeting**

April 23, 2009 4:00 P.M.  
San Diego Country Club  
88 L Street  
Chula Vista, CA 91911

**Investor Relations**

RICHARD M. SANBORN  
President & Chief Executive Officer  
Seacoast Commerce Bank  
678 3rd Avenue, Suite 310  
Chula Vista, CA 91910  
(619) 409-5762

**Listing of Common Stock and Warrants**

Seacoast Commerce Bank common stock is traded on the NASD Over-the-Counter market under the symbol **SCCB.OB**  
Seacoast Commerce Bank warrants are traded on the NASD Over-the-Counter market under the symbol **SCCBW.OB**

**Market Maker**

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rick@westfincorp.com

**Transfer Agent, Warrant Agent, and Registrar of Common Stock**

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(800) 866-1340

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**Corporate Counsel**

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