Oak Valley Bancorp
Form 10-K
March 28, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2010

OR

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

OAK VALLEY BANCORP

(Exact name of registrant as specified in its charter)

California	**26-2326676**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

95361

125 North Third Avenue **Oakdale, California** (Address of principal executive offices)	(Zip Code)

(209) 848-2265

(Registrant s telephone number including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	**Name of each exchange on which registered**
Common Stock	The NASDAQ Stock Market, LLC

Securities registered pursuant to Section 12(g) of the Act:

None

(Title of class)

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (232.405 of this chapter during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

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

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

Large accelerated filer o	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company x

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

As of December 31, 2010, the aggregate market value of the registrant s common stock held by non-affiliates of the registrant was $38,851,400 based on the closing price.

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Common Stock, No Par Value	**Outstanding at March 22, 2011**
[Common Stock, No par value per share]	7,713,794 shares

DOCUMENTS INCORPORATED BY REFERENCE

Document	**Parts Into Which Incorporated**
NONE	

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PART I

ITEM 1. BUSINESS OF OAK VALLEY BANCORP

Overview of the Business

Oak Valley Bancorp was incorporated on April 1, 2008 in California for the purpose of becoming Oak Valley Community Bank s parent bank holding company. Effective July 3, 2008, Oak Valley Bancorp acquired all of the outstanding capital stock of Oak Valley Community Bank (the Bank). The principal office of Oak Valley Bancorp is located at 125 North Third Avenue, Oakdale, California 95361 and its principal telephone is (209) 848-2265.

Oak Valley Bancorp is authorized to issue 50,000,000 shares of common stock, without par value, of which 7,713,794 are issued and outstanding, and 10,000,000 shares of preferred stock, without par value, of which 13,500 Series A preferred stock shares are issued or outstanding.

Oak Valley Community Bank commenced operations in May 1991. We are an insured bank under the Federal Deposit Insurance Act and are a member of the Federal Reserve. The Bank is subject to regulation, supervision and regular examination by the California Department of Financial Institutions and the Federal Reserve Bank (FRB). Since its formation, the Bank has provided basic banking services to individuals and business enterprises in Oakdale, California and the surrounding areas. The focus of the Bank is to offer a range of commercial banking services designed for both individuals and small to medium-sized businesses in the two main areas of service of the Bank: the Central Valley and the Eastern Sierras.

The Bank offers a complement of business checking and savings accounts for its business customers. The Bank also offers commercial and real estate loans, as well as lines of credit. Real estate loans are generally of a short-term nature for both residential and commercial purposes. Longer-term real estate loans are generally made with adjustable interest rates and contain normal provisions for acceleration. The Bank also offers traditional residential mortgages through a third party.

The Bank also offers other services for both individuals and businesses including online banking, remote deposit capture, merchant services, night depository, extended hours, wire transfer of funds, note collection, and automated teller machines in a national network. The Bank does not currently offer international banking or trust services although the Bank may make such services available to the Bank s customers through financial institutions with which the Bank has correspondent banking relationships. The Bank does not offer stock transfer services nor does it directly issue credit cards.

Expansion

Branch Expansion. Over the past few years, our network of branches and loan production offices have been expanded geographically. As of December 31, 2010, we maintained twelve full-service branch offices (in addition to our main office). Beginning in October 1995, we started our geographic expansion outside of Oakdale, by opening a Loan Production Office in Sonora, California. We subsequently opened a branch in Sonora and two branches in Modesto. In September 2000, we expanded into the Eastern Sierra, opening a branch in Bridgeport, California under the name Eastern Sierra Community Bank. Since that time we have added branches in Mammoth Lakes and Bishop. During 2005 and 2006, we aggressively increased our presence in the Central Valley, by opening branches in Turlock, Stockton, Patterson, Ripon and Escalon. In March 2007, our corporate headquarters expanded by adding an adjacent historical building located in downtown Oakdale to its complex. In 2010, we purchased a third branch in Modesto and signed a lease agreement to open a branch in Manteca. The new Modesto branch is expected to open in May and the new Manteca branch is expected to open in June. We intend to continue our growth strategy in future years through the opening of additional branches and loan production offices as our needs and resources permit.

Bank Holding Company Reorganization. Effective July 3, 2008, we entered into a bank holding company reorganization, whereby each of the Bank s outstanding shares of common stock converted into an equal number of shares of common stock in Oak Valley Bancorp, which currently owns the Bank as its wholly-owned subsidiary. Management believes that operating the Bank within a holding company structure provides, among other things, greater operating flexibility than operating as a bank; facilitates the acquisition of related businesses as opportunities arise; improves the Bank s ability to diversify; enhances the Bank s ability to remain competitive in the future with other companies in the financial services industry that are organized in a holding company structure; and improves the Bank s ability to raise capital to support growth. The reorganization was approved by the vote of the majority of the issued and outstanding shares of common stock.

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Business Segments

We operate in two primary business segments: Retail Banking and Commercial Banking. These segments are described in additional detail below:

Retail Banking. The Bank offers a range of checking and savings accounts, including NOW accounts, money market accounts, overdraft protection, health savings accounts, certificates of deposit, and Individual Retirement Accounts (IRA). To satisfy the lending needs of individuals in its service area, the Bank offers real estate and home equity financing, as well as consumer, automobile, and home improvement loans.

Commercial Banking. The Bank offers a range of deposit and lending services to business customers. More specifically, the Bank offers a variety of commercial loans for virtually any business, professional, or agricultural need. These include short-term working capital, operating lines of credit, equipment purchases, leasehold improvements, construction, commercial real estate acquisitions or refinancing. Currently, virtually all of the Bank s business relationships are with customers located in the San Joaquin, Stanislaus, Tuolumne, Inyo and Mono Counties.

Primary Market Area

We conduct business from our main office in Oakdale, a city of approximately 19,300 located in Stanislaus County, California. Oakdale is approximately 15 miles from Modesto and sits at the foothills of the Sierra Nevada Mountains, at the edge of the California Central Valley agricultural area. Through our branches, we serve customers in the Central Valley, from Fresno to Sacramento, and in foothill locations. We also reach into the Highway 395 corridor in the Eastern Sierras and in the towns of Bishop, Mammoth and Bridgeport. Approximately 92% of our loans and 88% of our deposits are generated from the Central Valley. The Central Valley area includes Stanislaus, San Joaquin and Tuolumne counties and has a total population of over 3 million.

Lending Activities

General.   Our loan policies set forth the basic guidelines and procedures by which we conduct our lending operations. These policies address the types of loans available, underwriting and collateral requirements, loan terms, interest rate and yield considerations, compliance with laws and regulations and our internal lending limits. Our Board of Directors reviews and approves our loan policies on an annual basis. We supplement our own supervision of the loan underwriting and approval process with periodic loan audits by experienced external loan specialists who review credit quality, loan documentation and compliance with laws and regulations. We engage in a full complement of lending activities, including:

• commercial real estate loans,

• commercial business lending and trade finance,

• Small Business Administration lending, and

• consumer loans, including automobile loans, home mortgages, credit lines and other personal loans.

As part of our efforts to achieve long-term stable profitability and respond to a changing economic environment in the California Central Valley, we constantly evaluate a variety of options to augment our traditional focus by broadening the services and products we provide. Possible avenues of growth include more branch locations, expanded days and hours of operation and new types of lending.

Loan Procedures. Loan applications may be approved by the Director Loan Committee of our Board of Directors, or by our management or lending officers, to the extent of their loan authority. Our Board of Directors authorizes our lending limits. Our President and Chief Credit Officer are responsible for evaluating the authority limits for individual credit officers and recommending lending limits for all other officers to the board of directors for approval.

We grant individual lending authority to our President, Chief Credit Officer, and to some department managers. Our highest management lending authority is combined administrative lending authority for unsecured and secured lending of $2,500,000, which requires the approval of our President or Chief Credit Officer. Loans for which direct and indirect borrower liability exceeds an individual s lending authority are referred to our Board of Directors Loan Committee.

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At December 31, 2010, our authorized legal lending limits were $10.7 million for unsecured loans plus an additional $7.1 million for specific secured loans. Legal lending limits are calculated in conformance with California law, which prohibits a bank from lending to any one individual or entity or its related interests an aggregate amount which exceeds 15% of primary capital plus the allowance for loan losses on an unsecured basis, plus an additional 10% on a secured basis. Our primary capital plus allowance for loan losses at December 31, 2010 totaled $71.4 million.

We seek to mitigate the risks inherent in our loan portfolio by adhering to certain underwriting practices. The review of each loan application includes analysis of the applicant s prior credit history, income level, cash flow and financial condition, tax returns, cash flow projections, and the value of any collateral to secure the loan, based upon reports of independent appraisers and audits of accounts receivable or inventory pledged as security. In the case of real estate loans over a specified amount, the review of collateral value includes an appraisal report prepared by an independent, Bank-approved, appraiser.

Real Estate Loans. We offer commercial real estate loans to finance the acquisition of new or the refinancing of existing commercial properties, such as office buildings, industrial buildings, warehouses, hotels, shopping centers, automotive industry facilities and multiple dwellings. At December 31, 2010, real estate loans constituted 89% of our loan portfolio, of which 81% were commercial loans.

Commercial real estate loans typically have 10-year maturities with up to 25-year amortization of principal and interest and loan-to-value ratios of not more than 75% of the appraised value or purchase price, whichever is lower. We usually impose a prepayment penalty during the period within 3 to 5 years of the date of the loan.

Construction loans are comprised of loans on commercial, residential and income producing properties that generally have terms of 1 year, with options to extend for additional periods to complete construction and to accommodate the lease-up period. We usually require 15% equity capital investment by the developer and loan to value ratios of not more than 75% of anticipated completion value.

Miniperm loans finance the purchase and/or ownership of commercial properties, including owner-occupied and income producing properties. We also offer miniperm loans as take-out financing with our construction loans. Miniperm loans are generally made with an amortization schedule ranging from 20 to 25 years, with a lump sum balloon payment due in 3 to 5 years.

Equity lines of credit are revolving lines of credit collateralized by junior deeds of trust on residential real properties. They generally bear a rate of interest that floats with our base rate or the prime rate, and have maturities of 10 years.

We purchase participation interests in loans made by other financial institutions as the need arises. These loans are subject to the same underwriting criteria and approval process as loans made directly by us.

Our real estate loans are typically collateralized by first or junior deeds of trust on specific commercial properties and equity lines of credit, and are subject to corporate or individual guarantees from financially capable parties, as available. The properties collateralizing real estate loans are principally located in our primary market areas of the California Central Valley and the Eastern Sierra. Real estate loans typically bear an interest rate that floats with our base rate, prime rate or another established index.

Our real estate portfolio is subject to certain risks, including (i) downturns in the California economy, (ii) interest rate increases, (iii) reduction in real estate values in the California Central Valley, (iv) increased competition in pricing and loan structure, and (v) environmental risks, including natural disasters. As a result of the high concentration of the real estate loan in our loan portfolio, the current difficulties in the real estate markets could cause significant increases in nonperforming loans, which would reduce our profits. A decline in real estate values could cause some of our mortgage loans to become inadequately collateralized, which would expose us to a greater risk of loss. Additionally, a decline in real estate values could adversely affect our portfolio of commercial real estate loans and could result in a decline in the origination of such loans. However, we strive to reduce the exposure to such risks and seek to continue to maintain high quality in our real estate loans by (a) reviewing each loan request and each loan renewal individually, (b) using a dual signature approval system for the approval of each loan request for loans over a certain dollar amount, (c) adhering to written loan policies, including, among other factors, minimum collateral requirements, maximum loan-to-value ratio requirements, cash flow requirements and personal guarantees, (d) performing secondary appraisals from time to time, (e) conducting external independent credit review, and (f) conducting environmental reviews, where appropriate. We review each loan request on the basis of our ability to recover both principal and interest in view of the inherent risks. We monitor and stress test our entire portfolio, evaluating debt coverage ratios and loan-to-value ratios, on a quarterly basis. We monitor trends and evaluate exposure derived from simulated stressed market conditions. The portfolio is stratified by owner classification (either owner occupied or non-owner occupied), product type, geography and size.

As of December 31, 2010, the aggregate loan-to-value of the entire commercial real estate portfolio was 55.6%. Historical data suggests that the Bank continues to maintain strong LTV, which has served as a cushion against precipitous reductions in real estate

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values. Non-owner occupied real estate comprises 45.7% of the Bank s total commitments, as of December 31, 2010. The loan-to-value on the non-owner occupied segment was 51.9%, as of December 31, 2010. The highest concentration by product type is retail, which comprised 28.2% of total CRE loan commitments outstanding, as of December 31, 2010.

Our portfolio diversity in terms of both product types and geographic distribution, combined with strong debt coverage ratios, a low aggregate loan-to-value and a high percentage of owner-occupied properties, significantly mitigate the risks associated with excessive commercial real estate concentration. These elements contribute strength to our overall real estate portfolio despite the current weakness in the real estate market.

Commercial Business Lending. We offer commercial loans to sole proprietorships, partnerships and corporations, with an emphasis on the real estate related industry. These commercial loans include business lines of credit and commercial term loans to finance operations, to provide working capital or for specific purposes, such as to finance the purchase of assets, equipment or inventory. Since a borrower s cash flow from operations is generally the primary source of repayment, our policies provide specific guidelines regarding required debt coverage and other important financial ratios.

Lines of credit are extended to businesses or individuals based on the financial strength and integrity of the borrower and are secured primarily by real estate, accounts receivable and inventory, and have a maturity of one year or less. Such lines of credit bear an interest rate that floats with our base rate, the prime rate, LIBOR or another established index.

Commercial term loans are typically made to finance the acquisition of fixed assets, refinance short-term debts or to finance the purchase of businesses. Commercial term loans generally have terms from one to five years. They may be collateralized by the asset being acquired or other available assets and bear interest rates, which either floats with the Bank s base rate, prime rate, LIBOR or another established index or is fixed for the term of the loan.

We also provide other banking services tailored to the small business market. We have focused recently on diversifying our loan portfolio, which has led to an increase in commercial real estate and commercial business loans to small and medium sized businesses.

Our portfolio of commercial loans is also subject to certain risks, including (i) downturns in the California economy, (ii) interest rate increases; and (iii) the deterioration of a borrower s or guarantor s financial capabilities. We attempt to reduce the exposure to such risks through (a) reviewing each loan request and renewal individually, (b) requiring a dual signature approval system, (c) mandating strict adherence to written loan policies, and (d) performing external independent credit review. In addition, we monitor loans based on short-term asset values on a monthly or quarterly basis. In general, during the term of the relationship, we receive and review the financial statements of our borrowing customers on an ongoing basis, and we promptly respond to any deterioration that we note.

Small Business Administration Lending Services. Small Business Administration, or SBA, lending, forms an important part of our business. Our SBA lending service places an emphasis on minority-owned businesses. Our SBA market area includes the geographic areas encompassed by our full-service banking offices in the California Central Valley and in the Eastern Sierra. Our SBA Loan Department has attained Preferred Lender status, which permits us to approve SBA guaranteed loans directly. As an SBA Preferred Lender, we provide quicker and more efficient service to our clientele, enabling them to obtain SBA loans in order to acquire new businesses, expand existing businesses, and acquire locations in which to do business, without having to go through the time consuming SBA approval process.

Although our participation in the SBA program is subject to the legislative power of Congress and the continued maintenance of our approved status by the SBA, we have no reason to believe that this program (and our participation therein) will not continue, particularly in view of the lengthy duration of the SBA program nationally.

Consumer Loans. Consumer loans include personal loans, auto loans, home improvement loans, home mortgage loans, revolving lines of credit and other loans typically made by banks to individual borrowers. We provide consumer loan products in an effort to diversify our product line.

Our consumer loan portfolio is subject to certain risks, including:

- amount of credit offered to consumers in the market,
- interest rate increases, and
- consumer bankruptcy laws which allow consumers to discharge certain debts.

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We attempt to reduce the exposure to such risks through the direct approval of all consumer loans by:

• reviewing each loan request and renewal individually,

• using a dual signature system of approval,

• strictly adhering to written credit policies and,

• performing external independent credit review.

Deposit Activities and Other Sources of Funds

Our primary sources of funds are deposits and loan repayments. Scheduled loan repayments are a relatively stable source of funds, whereas deposit inflows, outflows and unscheduled loan prepayments (which are influenced significantly by general interest rate levels, interest rates available on other investments, competition, economic conditions and other factors) are not as stable. Customer deposits also remain a primary source of funds, but these balances may be influenced by adverse market changes in the industry. We may resort to other borrowings, on an as needed basis, as follows:

• on a short-term basis to compensate for reductions in deposit inflows at less than projected levels, and

• on a longer-term basis to support expanded lending activities and to match the maturity of repricing intervals of assets.

We offer a variety of accounts for depositors, which are designed to attract both short-term and long-term deposits. These accounts include certificates of deposit, or CDs , regular savings accounts, money market accounts, checking and negotiable order of withdrawal, or NOW , accounts, savings accounts, health savings accounts and individual retirement accounts, or IRAs . These accounts generally earn interest at rates established by management based on competitive market factors and management s desire to increase or decrease certain types or maturities of deposits. As needs arise, we augment these customer deposits with brokered deposits. The more significant deposit accounts offered by us are described below:

Certificates of Deposit. We offer several types of CDs with a maximum maturity of five years. The substantial majority of our CDs have a maturity of one to twelve months and pay compounded interest typically credited monthly or at maturity.

Regular Savings Accounts. We offer savings accounts that allow for unlimited ATM and in-branch deposits and withdrawals. Interest is compounded daily and paid monthly.

Money Market Account. Money market accounts pay a variable interest rate that is tiered depending on the balance maintained in the account. Minimum opening balances vary. Interest is compounded daily and paid monthly.

Checking and NOW Accounts. Checking and NOW accounts are generally non-interest and interest bearing accounts, respectively, and may include service fees based on activity and balances. NOW accounts pay interest, but require a higher minimum balance to avoid service charges.

Federal Home Loan Bank Borrowings. To supplement our deposits as a source of funds for lending or investment, we borrow funds in the form of advances from the Federal Home Loan Bank. We regularly make use of Federal Home Loan Bank advances as part of our interest rate risk management, primarily to extend the duration of funding to match the longer term fixed rate loans held in the loan portfolio as part of our growth strategy.

As a member of the Federal Home Loan Bank system, we are required to invest in Federal Home Loan Bank stock based on a predetermined formula. Federal Home Loan Bank stock is a restricted investment security that can only be sold to other Federal Home Loan Bank members or redeemed by the Federal Home Loan Bank. As of December 31, 2010, we owned $3,380,700 in FHLB stock.

Advances from the Federal Home Loan Bank are typically secured by our entire real estate loan portfolio, which includes residential and commercial loans. At December 31, 2010, our borrowing limit with the Federal Home Loan Bank was approximately $122 million.

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Internet Banking

Since August 1, 2001, we have offered Internet banking service, which allows our customers to access their deposit accounts through the Internet. Customers are able to obtain transaction history and account information, transfer funds between accounts and make on-line bill payments. We intend to improve and develop our Internet banking products and delivery channels as the need arises and our resources permit.

Other Services

We also offer ATMs located at branch offices as well as seven other ATMs at various off site locations, and customer access to an ATM network.

Marketing

Our marketing relies principally upon local advertising and promotional activity and upon personal contacts by our directors, officers and shareholders to attract business and to acquaint potential customers with our personalized services. We emphasize a high degree of personalized client service in order to be able to provide for each customer s banking needs. Our marketing approach emphasizes the advantages of dealing with an independent, locally managed and state chartered bank to meet the particular needs of consumers, professionals and business customers in the community. Our management continually evaluates all of our banking services with regard to their profitability and efforts and makes determinations based on these evaluations whether to continue or modify our business plan, where appropriate.

We do not currently have any plans to develop any new lines of business, which would require a material amount of capital investment on our part.

Competition

Regional Branch Competition. We consider our primary service area to be composed of the counties of San Joaquin, Stanislaus, Tuolumne, Inyo and Mono Counties. The banking business in California generally, and in our primary service area, specifically, is competitive with respect to both loans and deposits and is dominated by a relatively small number of major banks which have many offices operating over wide geographic areas. These include Wells Fargo Bank, Bank of America, JP Morgan Chase Bank and Bank of the West. We compete for deposits and loans principally with these banks, as well as with savings and loan associations, thrift and loan associations, credit unions, mortgage companies, insurance companies, offerors of money market accounts and other lending institutions.

Among the advantages of these institutions is their ability to finance extensive advertising campaigns and to allocate their investment assets to regions of highest yield and demand, their ability to offer certain services, such as international banking and trust services which are not offered directly by the Bank and, the ability by virtue of their greater total capitalization, to have substantially higher lending limits than we do. In addition, as a result of increased consolidation and the passage of interstate banking legislation there is and will continue to be increased competition among banks, savings and loan associations and credit unions for the deposit and loan business of individuals and businesses.

As of June 30, 2010, our primary service areas contained one hundred sixty-eight (168) banking offices, with approximately $10.2 billion in total deposits. As of June 30, 2010, we had total deposits of approximately $436 million, which represented approximately 4.3% of the total deposits in the Bank s primary service area. There can be no assurance that the Bank will maintain its competitive position against current and potential competitors, especially those with greater resources than the Bank. The deposits of the four (4) largest competing banks averaged approximately $95 million per office as of June 30, 2010.

In order to compete with major financial institutions in our primary service areas, we use to the fullest extent the flexibility that our independent status permits. This includes an emphasis on specialized services, local promotional activity, and personal contacts by our officers, directors and employees. In the event that there are customers whose needs exceed our lending limits, we may arrange for such loans on a participation basis with other financial institutions. We also assist customers who require other services that we do not offer by obtaining such services from correspondent banks. However, no assurance can be given that our continued efforts to compete with other financial institutions will be successful.

In addition to other banks, our competitors include savings institutions, credit unions, and numerous non-banking institutions, such as finance companies, leasing companies, insurance companies, brokerage firms, and investment banking firms. In recent years, increased competition has also developed from specialized finance and non-finance companies that offer money market and mutual funds, wholesale finance, credit card, and other consumer finance services, including on-line banking services and personal finance

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software. Strong competition for deposit and loan products affects the rates of those products as well as the terms on which they are offered to customers.

Other Competitive Factors. The more general competitive trends in the industry include increased consolidation and competition. Strong competitors, other than financial institutions, have entered banking markets with focused products targeted at highly profitable customer segments. Many of these competitors are able to compete across geographic boundaries and provide customers increasing access to meaningful alternatives to banking services in nearly all significant products areas. Mergers between financial institutions have placed additional pressure on banks within the industry to streamline their operations, reduce expenses, and increase revenues to remain competitive. Competition has also intensified due to the federal and state interstate banking laws, which permit banking organizations to expand geographically, and the California market has been particularly attractive to out-of-state institutions. The Financial Modernization Act, which has made it possible for full affiliations to occur between banks and securities firms, insurance companies, and other financial companies, is also expected to intensify competitive conditions.

Technological innovations have also resulted in increased competition in the financial services industry. Such innovations have, for example, made it possible for non-depository institutions to offer customers automated transfer payment services that were previously considered traditional banking products. In addition, many customers now expect a choice of several delivery systems and channels, including telephone, mail, home computer, ATMs, self-service branches and/or in-store branches.

Business Concentration. No individual or single group of related accounts is considered material in relation to our total assets or deposits, or in relation to our overall business. However, approximately 89% of our loan portfolio held for investment at December 31, 2010 consisted of real estate-related loans, including construction loans, miniperm loans, real estate mortgage loans and commercial loans secured by real estate. Moreover, our business activities are currently focused primarily in Central California, with the majority of our business concentrated in San Joaquin, Stanislaus, Tuolumne, Inyo and Mono Counties. Consequently, our results of operations and financial condition are dependent upon the general trends in the Central California economies and, in particular, the residential and commercial real estate markets. In addition, the concentration of our operations in Central California exposes us to greater risk than other banking companies with a wider geographic base in the event of catastrophes, such as earthquakes, fires and floods in this region.

Employees

As of December 31, 2010, we had 123 employees (101 full-time employees and 22 part-time employees). None of our employees are currently represented by a union or covered by a collective bargaining agreement.

Bank Holding Company Regulation

Upon effectiveness of the bank holding company reorganization on July 2, 2008, we became subject to regulation under the Bank Holding Company Act of 1956, as amended (BHCA) which subjects Oak Valley Bancorp to Federal Reserve Board reporting and examination requirements. Under the Federal Reserve Board s regulations, a bank holding company is required to serve as a source of financial and managerial strength to its subsidiary banks.

The BHCA regulates the activities of holding companies including acquisitions, mergers, and consolidations and, together with the Gramm-Leach Bliley Act of 1999, the scope of allowable banking activities.

Government Policies, Legislation, and Regulatory Initiatives

The banking and financial services business in which we engage is highly regulated. Such regulation is intended, among other things, to protect depositors insured by the FDIC and the entire banking system. The commercial banking business is also influenced by the monetary and fiscal policies of the federal government and the policies of the Board of Governors of the Federal Reserve System, also known as the Federal Reserve Board. The Federal Reserve Board implements national monetary policies (with objectives such as curbing inflation and combating recession) by its open-market operations in United States Government securities, by adjusting the required level of reserves for financial intermediaries subject to its reserve requirements and by varying the discount rates applicable to borrowings by depository institutions. The actions of the Federal Reserve Board in these areas influence the growth of bank loans, investments and deposits and affects interest rates charged on loans and paid on deposits. Indirectly such actions may also impact the ability of non-bank financial institutions to compete with us. The nature and impact of any future changes in monetary policies cannot be predicted.

The laws, regulations and policies affecting financial services businesses are continuously under review by Congress and state legislatures and federal and state regulatory agencies. From time to time, legislation is enacted which has the effect of increasing the cost of doing business, limiting or expanding permissible activities or affecting the competitive balance between banks and other financial intermediaries. Proposals to change the laws and regulations governing the operations and taxation of banks, bank holding companies and other financial intermediaries are frequently made in Congress, in the California legislature and by various bank

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regulatory agencies and other professional agencies. Changes in the laws, regulations or policies that impact us cannot necessarily be predicted, but they may have a material effect on our business and earnings.

As a California state-chartered bank whose accounts are insured by the FDIC up to a maximum of $250,000 (as approved on October 10, 2008 by the FDIC through the end of 2009 and later revised on May 20, 2009 to extend the coverage through December 31, 2013), the Bank is subject to regulation, supervision and regular examination by the California Department of Financial Institutions and the Federal Reserve Bank (FRB). As a member of the Federal Reserve System, we are subject to certain regulations of the Board of Governors of the Federal Reserve System. The regulations of these agencies govern most aspects of our business, including the filing of periodic reports, and activities relating to dividends, investments, loans, borrowings, capital requirements, certain check-clearing activities, branching, mergers and acquisitions, reserves against deposits, and numerous other areas. Supervision, legal action and examination of us by the FRB is generally intended to protect depositors and is not intended for the protection of our shareholders.

The following discussion of statutes and regulations affecting banks is only a summary and does not purport to be complete. This discussion is qualified in its entirety by reference to such statutes and regulations. No assurance can be given that the referenced statutes or regulations will not change in the future.

Capital Adequacy Requirements

The federal banking agencies have adopted risk-based minimum capital guidelines intended to provide a measure of capital that reflects the degree of risk associated with a banking organization s operations for both transactions reported on the balance sheet as assets and transactions which are recorded as off balance sheet items. Under these guidelines, nominal dollar amounts of assets and credit equivalent amounts of off balance sheet items are multiplied by one of several risk adjustment percentages, which range from 0% for assets with low credit risk, such as federal banking agencies, to 100% for assets with relatively high credit risk. The higher the category, the more risk a bank is subject to and thus the more capital that is required.

The guidelines divide a bank s capital into two tiers. Tier I includes common equity, retained earnings, certain non-cumulative perpetual preferred stock, and minority interests in equity accounts of consolidated subsidiaries. Goodwill and other intangible assets (except for mortgage servicing rights and purchased credit card relationships, subject to certain limitations) are subtracted from Tier I capital. Tier II capital includes, among other items, cumulative perpetual and long-term, limited-life preferred stock, mandatory convertible securities, certain hybrid capital instruments, term subordinated debt and the allowance for loan losses (subject to certain limitations). Certain items are required to be deducted from Tier II capital. Banks must maintain a total risk-based ratio of 8%, of which at least 4% must be Tier I capital. As of December 31, 2010 and 2009, the Bank s Total Risk-Based Capital Ratio was 14.9% and 13.6%, and our Tier 1 Risk-Based Capital Ratio was 13.7% and 12.3%, respectively.

In addition to the risk-based guidelines, federal banking regulators require banking organizations to maintain a minimum amount of Tier 1 capital to total average assets, referred to as the leverage ratio. Banks that have received the highest rating of the five categories used by regulators to rate banks and are not anticipating or experiencing any significant growth must maintain a ratio of Tier 1 capital (net of all intangibles) to adjusted total assets, or Leverage Capital Ratio , of at least 3%. All other institutions are required to maintain a leverage ratio of at least 100 to 200 basis points above the 3% minimum, for a minimum of 4% to 5%. Pursuant to federal regulations, banks must maintain capital levels commensurate with the level of risk to which they are exposed, including the volume and severity of problem loans. As of December 31, 2010 and 2009, our Leverage Capital Ratios were 11.5% and 11.3%, respectively.

Federal banking regulators may set capital requirements higher than the minimums described above for financial institutions whose circumstances warrant it. For example, a financial institution experiencing or anticipating significant growth may be expected to maintain capital positions substantially above the minimum supervisory levels without significant reliance on intangible assets.

Prompt Corrective Action Provisions

Federal law requires each federal banking agency to take prompt corrective action to resolve the problems of insured financial institutions, including but not limited to those that fall below one or more prescribed minimum capital ratios. The federal banking agencies have by regulation defined the following five capital categories:

- well capitalized (Total Risk-Based Capital Ratio of 10%; Tier 1 Risk-Based Capital Ratio of 6%; and Leverage Ratio of 5%),

- adequately capitalized (Total Risk-Based Capital Ratio of 8%; Tier 1 Risk-Based Capital Ratio of 4%; and Leverage Ratio of 4% or 3% if the institution receives the highest rating from its primary regulator),

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- undercapitalized (Total Risk-Based Capital Ratio of less than 8%; Tier 1 Risk-Based Capital Ratio of less than 4%; or Leverage Ratio of less than 4% or 3% if the institution receives the highest rating from its primary regulator),

- significantly undercapitalized (Total Risk-Based Capital Ratio of less than 6%; Tier 1 Risk-Based Capital Ratio of less than 3%; or Leverage Ratio less than 3%), and

- critically undercapitalized (tangible equity to total assets less than 2%).

A bank may be treated as though it were in the next lower capital category if, after notice and the opportunity for a hearing, the appropriate federal agency finds an unsafe or unsound condition or practice so warrants, but no bank may be treated as critically undercapitalized unless its actual capital ratio warrants such treatment.

At each successively lower capital category, an insured bank is subject to increased restrictions on its operations. For example, a bank is generally prohibited from paying management fees to any controlling persons or from making capital distributions, if to do so would make the bank undercapitalized. Asset growth and branching restrictions apply to undercapitalized banks, which are required to submit written capital restoration plans meeting specified requirements (including a guarantee by the parent holding company, if any). Significantly undercapitalized banks are subject to broad regulatory authority, including among other things, capital directives, forced mergers, restrictions on the rates of interest they may pay on deposits, restrictions on asset growth and activities, and prohibitions on paying certain bonuses without FRB approval. Even more severe restrictions apply to critically undercapitalized banks. Most importantly, except under limited circumstances, the appropriate federal banking agency is required to appoint a conservator or receiver for an insured bank not later than 90 days after the bank becomes critically undercapitalized.

In addition to measures taken under the prompt corrective action provisions, insured banks may be subject to potential actions by federal regulators for unsafe or unsound practices in conducting their businesses or for violations of any law, rule, regulation or any condition imposed in writing by the agency or any written agreement with the agency. Enforcement actions may include the issuance of cease and desist orders, termination of insurance of deposits (in the case of a bank), the imposition of civil money penalties, the issuance of directives to increase capital, formal and informal agreements, or removal and prohibition orders against institution-affiliated parties.

Dividends

The payment of cash dividends by the Bank to Oak Valley Bancorp is subject to restrictions set forth in the California Financial Code (the Code). Prior to any distribution from the Bank to Oak Valley Bancorp, a calculation is made to ensure compliance with the provisions of the Code and to ensure that the Bank remains within capital guidelines set forth by the DFI and the FRB. In the event that the intended distribution from the Bank to Oak Valley Bancorp exceeds the restriction in the Code, advance approval from FRB is required. While advance approval may be required from the FRB for up to three years if we terminate our participation in the U.S. Treasury Capital Purchase Program, Management does not believe that these regulations will limit dividends from the Bank to meet the operating requirements of Bancorp for the foreseeable future. See Note 19 to the Consolidated Financial Statements in Item 8 of this report.

As long as the U.S. Treasury holds an equity position in us, we are restricted from increasing our dividends per common share without prior approval from the U.S. Treasury until December 5, 2011. We are also precluded from paying any dividends on common shares if we are in arrears on payment of dividends on preferred shares which are payable quarterly at an annual rate of 5%.

Safety and Soundness Standards

Federal banking agencies have also adopted guidelines establishing safety and soundness standards for all insured depository institutions. Those guidelines relate to internal controls, information systems, internal audit systems, loan underwriting and documentation, compensation and interest rate exposure. In general, the standards are designed to assist the federal banking agencies in identifying and addressing problems at insured depository institutions before capital becomes impaired. If an institution fails to meet these standards, the appropriate federal banking agency may require the institution to submit a compliance plan and institute enforcement proceedings, if an acceptable compliance plan is not submitted.

Premiums for Deposit Insurance

Our deposits are insured by the FDIC to the maximum amount permitted by law, which is currently $250,000 per depositor. On October 14, 2008, the FDIC announced the Temporary Transaction Account Guarantee Program to strengthen confidence in the banking system. The program was subsequently extended through December 31, 2010 at which time it expired. The rule allowed, at

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the participating FDIC-insured institutions option, full deposit insurance coverage for non-interest bearing transaction accounts and interest-bearing transaction accounts paying less than 0.25% regardless of the dollar amount. We elected to participate in the program by paying a 10 basis point surcharge on qualifying transaction accounts over $250,000. In addition, the FDIC finalized a change in the premium rate structure and imposed a uniform increase in minimum assessment from five cents to twelve cents annually for every $100 of domestic deposits on institutions that are assigned to the lowest risk category for the first calendar quarter of 2009. Effective April 1, 2009, assessment rates were adjusted to differentiate for risk. Banks in the best risk category pay a base rate from twelve to sixteen cents per $100 of deposits. Further, on May 22, 2009, the FDIC adopted a final rule imposing a 5-basis-point emergency special assessment on all insured depository institutions on June 30, 2009 that was collected on September 30, 2009.

On November 9, 2010, the FDIC issued a Final Rule implementing section 343 of the Dodd-Frank Wall Street Reform and Consumer Protection Act that provides for unlimited insurance coverage of noninterest-bearing transaction accounts. Beginning December 31, 2010, through December 31, 2012, all noninterest-bearing transaction accounts are fully insured, regardless of the balance of the account, at all FDIC-insured institutions. The unlimited insurance coverage is available to all depositors, including consumers, businesses, and government entities. This unlimited insurance coverage is separate from, and in addition to, the insurance coverage provided to a depositor s other deposit accounts held at an FDIC-insured institution.

On April 13, 2010, the FDIC adopted a final rule modifying the risk-based assessment system and setting initial base assessment rates beginning April 1, 2011, at 5 to 9 basis points for banks in the best risk category.

Community Reinvestment Act

We are subject to certain requirements and reporting obligations involving the Community Reinvestment Act, or CRA . The CRA generally requires federal banking agencies to evaluate the record of financial institutions in meeting the credit needs of local communities, including low and moderate-income neighborhoods. The CRA further requires that a record be kept of whether a financial institution meets its community credit needs, which record will be taken into account when evaluating applications for, among other things, domestic branches, consummating mergers or acquisitions, or holding company formations. In measuring a bank s compliance with its CRA obligations, the regulators now utilize a performance-based evaluation system, which bases CRA ratings on the bank s actual lending service and investment performance, rather than on the extent to which the institution conducts needs assessments, documents community outreach activities or complies with other procedural requirements. In connection with its assessment of CRA performance, the FRB assigns a rating of outstanding, satisfactory, needs to improve or substantial noncompliance. We were last examined for CRA compliance in August 24, 2009 and received an overall satisfactory CRA Assessment Rating.

Anti-Money Laundering Regulations

A series of banking laws and regulations beginning with the Bank Secrecy Act in 1970 require banks to prevent, detect, and report illicit or illegal financial activities to the federal government to prevent money laundering, international drug trafficking, and terrorism. Under the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, financial institutions are subject to prohibitions against specified financial transactions and account relationships as well as enhanced due diligence and know your customer standards in their dealings with high risk customers, foreign financial institutions, and foreign individuals and entities. We have extensive controls to comply with these requirements.

Privacy and Data Security

The Gramm-Leach Bliley Act (GLBA) of 1999 imposed requirements on financial institutions with respect to consumer privacy. The GLBA generally prohibits disclosure of consumer information to non-affiliated third parties unless the consumer has been given the opportunity to object and has not objected to such disclosure. Financial institutions are further required to disclose their privacy policies to consumers annually. The GLBA also directs federal regulators, including the FRB, to prescribe standards for the security of consumer information. We are subject to such standards, as well as standards for notifying consumers in the event of a security breach. We must disclose our privacy policy to consumers and permit consumers to opt out of having non-public customer information disclosed to third parties. We are required to have an information security program to safeguard the confidentiality and security of customer information and to ensure proper disposal. Customers must be notified when unauthorized disclosure involves sensitive customer information that may be misused.

Other Consumer Protection Laws and Regulations

Bank regulatory agencies are increasingly focusing on compliance with consumer protection laws and regulations. Examination and enforcement has become intense, and banks have been advised to monitor compliance carefully with various consumer protection

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laws and their implementing regulations. For example, the federal Interagency Task Force on Fair Lending issued a policy statement on discrimination in home mortgage lending describing three methods that federal agencies will use to prove discrimination: overt evidence of discrimination, evidence of disparate treatment, and evidence of disparate impact. In addition to CRA and fair lending requirements, we are subject to numerous other federal consumer protection statutes and regulations. Due to heightened regulatory concern related to compliance with consumer protection laws and regulations generally, we may incur additional compliance costs or be required to expend additional funds for investments in the local communities we serve.

Interstate Banking and Branching The Riegle-Neal

The Interstate Banking and Branching Efficiency Act of 1994, or Interstate Banking Act, regulates the interstate activities of banks and bank holding companies and establishes a framework for nationwide interstate banking and branching. Since June 1, 1997, a bank in one state has generally been permitted to merge with a bank in another state without the need for explicit state law authorization. However, states were given the ability to prohibit interstate mergers of banks in their own state by opting-out (enacting state legislation prohibiting such mergers) prior to June 1, 1997.

Since 1995, adequately capitalized and managed bank holding companies have been permitted to acquire banks located in any state, subject to two exceptions: first, any state may still prohibit bank holding companies from acquiring a bank which is less than five years old; and second, no interstate acquisition can be consummated by a bank holding company if the acquirer would control more than 10% of the deposits held by insured depository institutions nationwide or 30% or more of the deposits held by insured depository institutions in any state in which the target bank has branches.

A bank may establish and operate *de novo* branches in any state in which the bank does not maintain a branch, if that state has enacted legislation to expressly permit all out-of-state banks to establish branches in that state.

In 1995, California enacted legislation to implement important provisions of the Interstate Banking Act and to repeal California s previous interstate banking laws, which were largely preempted by the Interstate Banking Act.

The changes effected by the Interstate Banking Act and California laws have increased competition in our market by permitting out-of-state financial institutions to enter our market areas directly or indirectly. We believe that the Interstate Banking Act has contributed to the accelerated consolidation of the banking industry. Although many large out-of-state banks have already entered the California market as a result of this legislation, it is not possible to predict the precise impact of this legislation on us and the competitive environment in which we operate.

USA Patriot Act of 2001

On October 26, 2001, President Bush signed the USA Patriot Act of 2001, or Patriot Act . The Patriot Act was enacted in response to the terrorist attacks in New York, Pennsylvania and Washington, D.C. on September 11, 2001, and is intended to strengthen U.S. law enforcement s and the intelligence community s ability to work cohesively to combat terrorism on a variety of fronts. The potential impact of the Patriot Act on financial institutions is significant and wide ranging. The Act contains sweeping anti-money laundering and financial transparency laws and requires various regulations, including:

• due diligence requirements for financial institutions that administer, maintain, or manage private bank accounts or correspondent accounts for non-U.S. persons,

• standards for verifying customer identification at account opening,

• rules to promote cooperation among financial institutions, regulators, and law enforcement entities in identifying parties that may be involved in terrorism or money laundering,

• reports by non-financial trades and business filed with the Treasury Department s Financial Crimes Enforcement Network for transactions exceeding $10,000, and

• filing of suspicious activities reports if they believe a customer may be violating U.S. laws and regulations.

Currently we are unable to quantify the impact the Patriot Act has had or may in the future have on our financial condition or results of operations.

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The Sarbanes-Oxley Act of 2002

On July 30, 2002, President Bush signed into law The Sarbanes-Oxley Act of 2002, or Sarbanes-Oxley Act . The Sarbanes-Oxley Act addresses accounting oversight and corporate governance matters relating to the operations of public companies. During 2003, the Commission issued a number of regulations under the directive of the Sarbanes-Oxley Act significantly increasing public company governance-related obligations and filing requirements, including:

• the establishment of an independent public oversight of public company accounting firms by a board that will set auditing, quality and ethical standards for and have investigative and disciplinary powers over such accounting firms,

• the enhanced regulation of the independence, responsibilities and conduct of accounting firms which provide auditing services to public companies,

• the increase of penalties for fraud related crimes,

• the enhanced disclosure, certification, and monitoring of financial statements, internal financial controls and the audit process, and

• the enhanced and accelerated reporting of corporate disclosures and internal governance.

Furthermore, in November 2003, in response to the directives of the Sarbanes-Oxley Act, Nasdaq adopted substantially expanded corporate governance criteria for the issuers of securities quoted on the Nasdaq markets. The new Nasdaq rules govern, among other things, the enhancement and regulation of corporate disclosure and internal governance of listed companies and of the authority, role and responsibilities of their boards of directors and, in particular, of independent members of such boards of directors, in the areas of nominations, corporate governance, compensation and the monitoring of the audit and internal financial control processes.

The Sarbanes-Oxley Act, the Commission rules promulgated thereunder, and the new Nasdaq governance requirements have required the Bank to review its current procedures and policies to determine whether they comply with the new legislation and its implementing regulations. Oak Valley Bancorp will be primarily responsible for ensuring compliance with Sarbanes-Oxley and the Nasdaq governance rules, as applicable. Although the impact these new requirements will have upon the Oak Valley Bancorp s and the Bank s operations is not entirely clear, the Bank has already experienced an increase in expenditures associated with certain outside professional costs necessary for compliance.

The Emergency Economic Stabilization Act and its Related Government Policies, Legislations, and Regulations

Dramatic negative developments in the latter half of 2007 in the subprime mortgage market and the securitization markets for such loans, together with volatility in oil prices and other factors, have resulted in uncertainty in the financial markets in general and a related economic downturn, which continued through 2010 and is anticipated to continue through 2011. Dramatic declines in the housing market, with decreasing home prices and increasing delinquencies and foreclosures, have negatively impacted the credit performance of mortgage and construction loans and resulted in significant write-downs of assets by many financial institutions. In addition, the values of real estate collateral supporting many commercial and residential loans have declined and may continue to decline. General downward economic trends, reduced availability of commercial credit and increasing unemployment have negatively impacted the credit performance of commercial and consumer credit, resulting in additional write-downs. Concerns over the stability of the financial markets and the economy have resulted in decreased lending by many financial institutions to their customers and to each other. This market turmoil and tightening of credit has led to increased commercial and consumer delinquencies, lack of customer confidence, increased market volatility and widespread reduction in general business activity. Competition among depository institutions for deposits has increased significantly. Bank and bank holding company stock prices have been negatively affected as has the ability of banks and bank holding companies to raise capital or borrow in the debt markets compared to recent years. Bank regulators have been very aggressive in responding to concerns and trends identified in examinations, and this has resulted in the increased issuance of formal and informal enforcement orders and other supervisory actions requiring action to address credit quality, liquidity and risk management and capital adequacy, as well as other safety and soundness concerns.

On October 3, 2008, the Emergency Economic Stabilization Act of 2008 (EESA) was enacted to restore confidence and stabilize the volatility in the U.S. banking system and to encourage financial institutions to increase their lending to customers and to each other. Initially introduced as the Troubled Asset Relief Program (TARP), the EESA authorized the United States Department of the Treasury (U.S. Treasury) to purchase from financial institutions and their holding companies up to $700 billion in mortgage loans, mortgage-related securities and certain other financial instruments, including debt and equity securities issued by financial

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institutions and their holding companies. Initially, $350 billion was made immediately available to the U.S. Treasury. On January 15, 2009, the remaining $350 billion was released to the U.S. Treasury.

On October 14, 2008, the U.S. Treasury announced its intention to inject capital into nine large U.S. financial institutions under the TARP Capital Purchase Program (the TARP CPP), and since has injected capital into many other financial institutions, including the Company. The U.S. Treasury initially allocated $250 billion towards the TARP CPP.

In order to participate in the TARP CPP, financial institutions were required to adopt certain standards for executive compensation and corporate governance. These standards generally apply to the Chief Executive Officer, Chief Financial Officer and the three next most highly compensated senior executive officers. The standards include (1) ensuring that incentive compensation for named senior executives does not encourage unnecessary and excessive risks that threaten the value of the financial institution; (2) required clawback of any bonus or incentive compensation paid to a senior executive based on statements of earnings, gains or other criteria that are later proven to be materially inaccurate; (3) prohibition on making golden parachute payments to senior executives; and (4) agreement not to deduct for tax purposes executive compensation in excess of $500,000 for each senior executive. The Company has complied with these requirements and will continue to comply.

The bank regulatory agencies, U.S. Treasury and the Office of Special Inspector General, also created by the EESA, have issued guidance and requests to the financial institutions that participated in the TARP CPP to document their plans and use of TARP CPP funds and their plans for addressing the executive compensation requirements associated with the TARP CPP. The Company has received and responded to that request.

On February 17, 2009, the American Recovery and Reinvestment Act of 2009 (ARRA) was signed into law by President Obama. The ARRA includes a wide variety of programs intended to stimulate the economy and provide for extensive infrastructure, energy, health, and education needs. In addition, the ARRA imposes certain new executive compensation and corporate expenditure limits on all current and future TARP recipients, including the Company, until the institution has repaid the U.S. Treasury, which is now permitted under the ARRA without penalty and without the need to raise new capital, subject to the U.S. Treasury s consultation with the recipient s appropriate regulatory agency.

The ARRA executive compensation standards that went into effect on September 14, 2009 are more stringent than those currently in effect under the TARP CPP or those previously proposed by the U.S. Treasury. The new standards include (but are not limited to); (i) prohibitions on bonuses, retention awards and other incentive compensation, other than restricted stock grants which do not fully vest during the TARP CPP period up to one-third of an employee s total annual compensation, (ii) prohibitions on golden parachute payments for departures, (iii) an expanded clawback of bonuses, retention awards, and incentive compensation if payment is based on materially inaccurate statements of earnings, revenues, gains or other criteria, (iv) prohibitions on compensation plans that encourage manipulation of reported earnings, (v) retroactive review of bonuses, retention awards and other compensation previously provided by TARP CPP recipients if found by the U.S. Treasury to be inconsistent with the purposes of TARP CPP or otherwise contrary to public interest, (vi) required establishment of a company-wide policy regarding excessive or luxury expenditures, and (vii) inclusion in a participant s proxy statements for annual shareholder meetings of a nonbinding Say on Pay shareholder vote on the compensation of executives.

The Dodd-Frank Wall Street Reform and Consumer Protection Act

On July 21, 2010, President Obama signed into law the sweeping financial regulatory reform act entitled the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) that implements significant changes to the regulation of the financial services industry, including provisions that, among other things:

- Centralize responsibility for consumer financial protection by creating a new agency within the Federal Reserve Board, the Bureau of Consumer Financial Protection, with broad rulemaking, supervision and enforcement authority for a wide range of consumer protection laws that would apply to all banks and thrifts. Smaller financial institutions, including the Bank, will be subject to the supervision and enforcement of their primary federal banking regulator with respect to the federal consumer financial protection laws.

- Apply the same leverage and risk-based capital requirements that apply to insured depository institutions to bank holding companies.

- Require the FDIC to seek to make its capital requirements for banks countercyclical so that the amount of capital required to be maintained increases in times of economic expansion and decreases in times of economic contraction.

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- Change the assessment base for federal deposit insurance from the amount of insured deposits to consolidated assets less tangible capital.

- Implement corporate governance revisions, including executive compensation and proxy access by stockholders.

- Make permanent the $250,000 limit for federal deposit insurance and increase the cash limit of Securities Investor Protection Corporation protection from $100,000 to $250,000, and provide unlimited federal deposit insurance until January 1, 2013 for non-interest bearing demand transaction accounts at all insured depository institutions.

- Repeal the federal prohibitions on the payment of interest on demand deposits effective July 21, 2011, thereby permitting depository institutions to pay interest on business transaction and other accounts.

Many aspects of the Dodd-Frank Act are subject to rulemaking by various regulatory agencies and are expected to take effect over several years, making it difficult to anticipate the overall financial impact on the Company, its customers or the financial industry more generally. The elimination of the prohibition on the payment of interest on demand deposits could materially increase our interest expense, depending on our competitors responses. Provisions in the legislation that require revisions to the capital requirements of the Company and the Bank could require the Company and the Bank to seek additional sources of capital in the future.

Environmental Regulations

In the course of our business, we may foreclose and take title to real estate, and could be subject to environmental liabilities with respect to these properties. We may be held liable to a governmental entity or to third parties for property damage, personal injury, investigation and clean-up costs incurred by these parties in connection with environmental contamination, or may be required to investigate or clean up hazardous or toxic substances, or chemical releases at a property. The costs associated with investigation or remediation activities could be substantial. In addition, as the owner or former owner of a contaminated site, we may be subject to common law claims by third parties based on damages and costs resulting from environmental contamination emanating from the property. If we ever become subject to significant environmental liabilities, our business, financial condition, liquidity and results of operations could be materially and adversely affected.

Other Pending and Proposed Legislation

Other legislative and regulatory initiatives which could affect us and the banking industry, in general, are pending and additional initiatives may be proposed or introduced before the United States Congress, the California legislature and other governmental bodies in the future. Such proposals, if enacted, may further alter the structure, regulation and competitive relationship among financial institutions, and may subject us to increased regulation, disclosure and reporting requirements. In addition, the various banking regulatory agencies often adopt new rules and regulations to implement and enforce existing legislation. We cannot predict whether, or in what form, any such legislation or regulations may be enacted or the extent to which our business would be affected thereby.

Available Information

The Company maintains an Internet website at http://www.ovcb.com. The Company makes available its annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to such reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and other information related to the Company free of charge, through this site as soon as reasonably practicable after it electronically files those documents with, or otherwise furnishes them to, the SEC. The Company s internet website and the information contained therein or connected thereto are not intended to be incorporated into this annual report on Form 10-K.

ITEM 1A. RISK FACTORS

Not applicable.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

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ITEM 2. PROPERTIES

Our main office is located in a complex at 125 North Third Avenue, Oakdale, CA 95361, in downtown Oakdale and houses our primary loan production, operations, and administrative offices. The building has an automated teller machine and onsite parking. The Bank s complex occupies approximately 20,000 square feet of space.

Property Location and Address	Square Footage	Lease Expiration Date	Lease Extension Options
Oakdale, 125 N. 3rd Ave.	9,600	n/a*	n/a*
Oakdale, 338 F Street	9,860	3/2017	three, 5-year term extensions
Sonora, 14580 Mono Way	2,500	4/2013	n/a
Modesto, 12th & I Street	4,500	3/2016	two, 5-year term extensions
Bridgeport, 166 Main Street	2,875	n/a*	n/a*
Mammoth Lakes, 170 Mountain Blvd.	1,856	n/a*	n/a*
Bishop, 351 North Main Street	3,680	8/2014	two, 5-year term extensions
Modesto, 4120 Dale Road	4,500	3/2015	two, 5-year term extensions
Turlock, 2001 Geer Road	2,400	1/2015	two, 5-year term extensions
Patterson, 20 Plaza Circle	2,100	n/a*	n/a*
Escalon, 1910 McHenry Ave.	3,500	4/2021	two, 5-year term extensions
Ripon, 150 North Wilma Ave.	1,800	1/2011	two, 5-year term extensions
Stockton, 2935 West March Lane	8,000	12/2022	two, 5-year term extensions
Modesto, 3508 McHenry Ave.**	5,400	n/a*	n/a*
Manteca, 191 W. North St. ***	2,800	5/31/2016	two, 5-year term extensions

* The Bank owns this property.

** Expected to open May 2011.

*** Expected to open June 2011.

Management has determined that all of its premises are adequate for its present and anticipated level of business.

ITEM 3. LEGAL PROCEEDINGS

From time to time, the Company is a party to claims and legal proceedings arising in the ordinary course of business. Our management evaluates its exposure to these claims and proceedings individually and in the aggregate and provides for potential losses on such litigation if the amount of the loss is estimable and the loss is probable.

We believe that there are no material litigation matters at the current time. Although the results of such litigation matters and claims cannot be predicted with certainty, we believe that the final outcome of any such claims and proceedings will not have a material adverse impact on the Company s financial position, liquidity, or results of operations.

ITEM 4. REMOVED AND RESERVED

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PART II

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

Price Range of Common Stock

Our common stock is traded on the NASDAQ Capital Market under the symbol OVLY. The following table sets forth the high and low closing bid prices (which reflect prices between dealers and do not include retail markup, markdown or commission and may not represent actual transactions) for the current year and the two calendar years ended December 31, 2010 and 2009, respectively. From time to time, during the periods indicated, trading activity in our common stock was infrequent. The source of the quotes is The Nasdaq Stock Market, LLC.

	Closing Sale Price	
For Calendar Quarter Ended	**High**	**Low**
March 31, 2009	6.00	3.75
June 30, 2009	4.92	2.75
September 30, 2009	5.10	3.75
December 31, 2009	5.00	4.10
March 31, 2010	4.60	4.00
June 30, 2010	6.50	4.10
September 30, 2010	5.94	4.83
December 31, 2010	6.00	5.08

On March 22, 2011, the closing price of our common stock was $5.91 per share; and there were approximately 506 shareholders of record of the common stock and 7,713,794 outstanding shares of common stock.

Dividends

Our ability to pay any cash dividends will depend not only upon our earnings during a specified period, but also on our meeting certain capital requirements.

Shareholders are entitled to receive dividends only when and if dividends are declared by our Board of Directors. Although we have paid dividends in the past, it is no guarantee that we will continue paying cash dividends in the future.

No dividends were paid for the year ended December 31, 2010. Dividends for the year ended December 31, 2009 were $0.025 per share of common stock.

For additional information regarding our ability to pay dividends, see discussion in Note 12 to the Consolidated Financial Statement, in Item 8 of this report.

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Equity Compensation Plan Information

The following table provides information as of December 31, 2010 with respect to shares of our common stock that are issued and currently outstanding under the Bank s 1998 Restated Stock Option Plan (the 1998 Restated Stock Option Plan), and the number of shares that are authorized to be issued under the Company s 2008 Stock Option Plan (the 2008 Equity Plan). Figures in the table have been retroactively adjusted to reflect three-for-two stock splits in August 2005 and 2006.

Plan Category	A Number of Securities to be Issued Upon Exercise of Outstanding Options	B Weighted Average Exercise Price of Outstanding Options	C Number of Securities Remaining Available for Future Issuance Under 2008 Equity Plan (Excluding Securities Reflected in Column A)
Equity Compensation Plans Approved by Shareholders	287,922	$ 8.09	1,497,500
Equity Compensation Plans Not Approved by Shareholders (1)	350,346	5.78	0
Total	638,268	$ 6.46	1,497,500

(1) Consists of a warrant issued to the U.S. Treasury to purchase 350,346 shares of the Company s common stock. The warrant is immediately exercisable and has a 10-year term with an initial exercise price of $5.78 pursuant to a Letter Agreement of Securities Purchase dated December 5, 2008.

ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

Not applicable.

ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OFOPERATION

The following discussion of financial condition as of December 31, 2010 and 2009 and results of operations for each of the years in the three-year period ended December 31, 2010 should be read in conjunction with our consolidated financial statements and related notes thereto, included in this report. Average balances, including balances used in calculating certain financial ratios, are generally comprised of average daily balances.

Forward-Looking Statements

This discussion of financial results includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, (the 1933 Act) and Section 21E of the Securities Exchange Act of 1934, as amended, (the 1934 Act). Those sections of the 1933 Act and 1934 Act provide a safe harbor for forward-looking statements to encourage companies to provide prospective information about their financial performance so long as they provide meaningful, cautionary statements identifying important factors that could cause actual results to differ significantly from projected results.

Our forward-looking statements include descriptions of plans or objectives of Management for future operations, products or services, and forecasts of our revenues, earnings or other measures of economic performance. Forward-looking statements can be identified by the fact that they do not relate strictly to historical or current facts. They often include the words believe, expect, intend, estimate or words of similar meaning, or future or conditional verbs such as will, would, should, could or may.

Forward-looking statements are based on Management s current expectations regarding economic, legislative, and regulatory issues that may impact our earnings in future periods. A number of factors - many of which are beyond Management s control - could cause future results to vary materially from current Management s expectations. Such factors include, but are not limited to, general economic conditions, the current financial turmoil in the United States and abroad, changes in interest rates, deposit flows, real estate values and industry competition; changes in accounting principles, policies or guidelines; changes in legislation or regulation; and other economic, competitive, governmental, regulatory and technological factors affecting our operations, pricing, products and services. Forward-looking statements speak only as of the date they are made. We do not undertake to update forward-looking statements to reflect circumstances or events that occur after the date the forward-looking statements are made or to reflect the occurrence of unanticipated events.

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Introduction

Our continued focus on responsible community banking fundamentals and our strong customer relationships have enabled us to increase profitability in 2010, and have led to higher deposits, a core funding source for our steady asset growth.

As of December 31, 2010, we had approximately $552 million in total assets, $404 million in total loans, and $477 million in total deposits.

We believe the following were key indicators of our performance for operations during 2010:

• our total assets increased to $552 million at the end of 2010, an increase of 5.3%, from $525 million at the end of 2009.

• our total deposits increased to $477 million at the end of 2010, an increase of 11.1%, from $429 million at the end of 2009.

• our total net loans decreased to $395 million at the end of 2010, a decrease of 5.4%, from $418 million at the end of 2009.

• our ratio of total non-performing loans to total loans decreased to 2.8% at December 31, 2010 from 3.4% at December 31, 2009. Management considers that the size of the ratio of non-performing assets to total loans is moderate and manageable, and reserves have been taken appropriately.

• net interest income increased $1.4 million or 5.8% in 2010 compared to 2009, mainly as a result of an increase in the net interest margin from 4.99% to 5.20% and an increase in average earning assets of $4.5 million.

• provision for loan losses decreased $1.84 million or 31.4% to $4.02 million in 2010 compared to $5.86 million in 2009.

• total noninterest income increased to $2.77 million in 2010, an increase of 4.9%, from $2.64 million in 2009. We primarily attribute this increase to our efforts to expand our deposit account base and diversify our non-interest revenue sources.

• total noninterest expense decreased from $18.2 million in 2009 to $16.8 million in 2010, reflecting the decrease in fair market value write downs on other real estate owned.

These items, as well as other factors, contributed to the increase in net income available to common shareholders for 2010 to $3.79 million from $1.16 million in 2009, which translates into $0.49 per diluted common share in 2010 and $0.15 per diluted common share in 2009.

Over the past few years, our network of branches and loan production offices have been expanded geographically. We currently maintain twelve full-service offices. We intend to continue our growth strategy in future years through the opening of additional branches and loan production offices as our needs and resources permit.

2011 Outlook

As we begin our strategic business plan for 2011, we are continuing to pursue opportunities for growth in our existing markets, as well as opportunities to expand into new markets through *de novo* branching. Further, we expect that our portfolio of small business loans will overall experience additional growth in 2011 as a result of targeted marketing efforts in this area.

In 2011, we are continuing to focus on loan and account growth and managing our net interest margin, while attempting to control expenses and credit losses and manage our business to achieve our net income and other objectives. Efforts to attract new accounts and grow loans continues to be an important strategic initiative.

Although interest rates remained flat at historic lows in 2010, we have increased our net interest margin with continued growth in net interest income, which we expect could slightly compress in 2011 if interest rates begin to increase. This potential compression of net interest margin and net interest income would be a likely outcome if interest rates increase given that are balance sheet is liability sensitive to interest rate changes primarily due to the number of loans currently at their contractual rate floors and competitive pressures to increase deposit rates. This could in turn result in a slower increase on the yield of earning assets compared to the cost of deposits and other funds. Ideally, if we experience an increase in our yield on earnings assets we could then determine to increase the interest rates we pay on our deposit accounts or change our promotional or other interest rates on new deposits in marketing activation programs to attempt to achieve a certain net interest margin. In light of the current economic environment, it may not be possible to manage the interest margin in this manner, as competitive pressures may dictate that we increase deposit rates at a

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faster rate than the earning assets increase, thereby further compressing the net interest margin. Any increases in the rates we charge on accounts could have an effect on our efforts to attract new customers and grow loans, particularly with the continuing competition in the commercial and consumer lending industry. The economies and real estate markets in our primary market areas will continue to be significant determinants of the quality of our assets in future periods and, thus, our results of operations, liquidity and financial condition. Current economic indicators suggest that the national economy and the economies in our primary market areas will remain depressed but the length and severity of the cycle is difficult to predict.

For 2011, management remains focused on the above challenges and opportunities and other factors affecting the business similar to the factors driving 2010 results as discussed in this section.

Holding Company

Effective July 3, 2008, Oak Valley Community Bank became a subsidiary of Oak Valley Bancorp, a newly established bank holding company. Oak Valley Bancorp operates Oak Valley Community Bank as a community bank in the general commercial banking business, with our primary market encompassing the California Central Valley around Oakdale and Modesto, and the Eastern Sierras. As such, unless otherwise noted, all references are about Oak Valley Community Bank.

In the bank holding company reorganization, all outstanding shares of common stock of the bank were exchanged for an equal number of shares of common stock of Oak Valley Bancorp, which now owns the Bank as its wholly-owned subsidiary. Management believes that operating the Bank within a holding company structure, among other things:

• provides greater operating flexibility than is currently enjoyed by us.

• facilitates the acquisition of related businesses as opportunities arise.

• improves our ability to diversify.

• enhances our ability to remain competitive in the future with other companies in the financial services industry that are organized in a holding company structure.

• enhances our ability to raise capital to support growth.

The financial statements and discussion thereof contained in this report for periods subsequent to the reorganization relate to the consolidated financial statements of Oak Valley Bancorp. Periods prior to the reorganization relate to the Bank only. The information is comparable as the sole subsidiary of Oak Valley Bancorp is the Bank.

Critical Accounting Policies

Critical accounting policies are those that are both most important to the portrayal of our financial condition and results of operations and require management s most difficult, subjective, or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain.

The discussion and analysis of our financial condition and results of operations is based upon our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates and judgments that effect the reported amounts of assets and liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities at the date of our financial statements. Actual results may differ from these estimates under different assumptions or conditions. In addition, GAAP itself may change from one previously acceptable method to another method, although the economics of our transactions would be the same.

Management has determined the following accounting policies to be critical:

Asset Impairment Judgments

Certain of our assets are carried in our statements of financial condition at fair value or at the lower of cost or fair value. Valuation allowances are established when necessary to recognize impairment of such assets. We periodically perform analyses to test for impairment of various assets. In addition to our impairment analyses related to loans, another significant impairment analysis relates to other than temporary declines in the value of our securities.

Our available for sale portfolio is carried at estimated fair value, with any unrealized gains and losses, net of taxes, reported as accumulated other comprehensive income in stockholders equity. We conduct a periodic review and evaluation of the securities

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portfolio to determine if the value of any security has declined below its carrying value and whether such decline is other than temporary. If such decline is deemed other than temporary, we would adjust the carrying amount of the security by writing down the security to fair market value through a charge to current period income. The market values of our securities are significantly affected by changes in interest rates.

In general, as interest rates rise, the market value of fixed-rate securities will decrease; as interest rates fall, the market value of fixed-rate securities will increase. With significant changes in interest rates, we evaluate our intent and ability to hold the security for a sufficient time to recover the recorded principal balance. Estimated fair values for securities are based on published or securities dealers market values. Market volatility is unpredictable and may impact such values.

Allowance for Loan Losses

Credit risk is inherent in the business of lending and making commercial loans. Accounting for our allowance for loan losses involves significant judgment and assumptions by management and is based on historical data and management s view of the current economic environment. At least on a quarterly basis, our management reviews the methodology and adequacy of allowance for loan losses and reports its assessment to the Board of Directors for its review and approval.

The allowance for loan losses is an estimate of probable incurred losses with regard to our loans. Our loan loss provision for each period is dependent upon many factors, including loan growth, net charge-offs, changes in the composition of the loans, delinquencies, management s assessment of the quality of the loans, the valuation of problem loans and the general economic conditions in our market area. We base our allowance for loan losses on an estimation of probable losses inherent in our loan portfolio.

Our methodology for assessing loan loss allowances are intended to reduce the differences between estimated and actual losses and involves a detailed analysis of our loan portfolio, in three phases:

- the specific review of individual loans,

- the segmenting and review of loan pools with similar characteristics, and

- our judgmental estimate based on various subjective factors:

The first phase of our methodology involves the specific review of individual loans to identify and measure impairment. We evaluate each loan by use of a risk rating system, except for homogeneous loans, such as automobile loans and home mortgages. Specific risk rated loans are deemed impaired if all amounts, including principal and interest, will likely not be collected in accordance with the contractual terms of the related loan agreement. Impairment for commercial and real estate loans is measured either based on the present value of the loan s expected future cash flows or, if collection on the loan is collateral dependent, the estimated fair value of the collateral, less selling and holding costs.

The second phase involves the segmenting of the remainder of the risk rated loan portfolio into groups or pools of loans, together with loans with similar characteristics, for evaluation. We determine the calculated loss ratio to each loan pool based on its historical net losses and benchmark it against the levels of other peer banks.

In the third phase, we consider relevant internal and external factors that may affect the collectability of loan portfolio and each group of loan pool. The factors considered are, but are not limited to:

• concentration of credits,

• nature and volume of the loan portfolio,

• delinquency trends,

• non-accrual loan trend,

• problem loan trend,

• loss and recovery trend,

• quality of loan review,

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- lending and management staff,
- lending policies and procedures,
- economic and business conditions, and
- other external factors.

Our management estimates the probable effect of such conditions based on our judgment, experience and known or anticipated trends. Such estimation may be reflected as an additional allowance to each group of loans, if necessary. Management reviews these conditions with our senior credit officers. To the extent that any of these conditions is evidenced by a specifically identifiable problem credit or portfolio segment as of the evaluation date, management s estimate of the effect of such condition may be reflected as a specific allowance applicable to such credit or portfolio segment. Where any of these conditions is not evidenced by a specific, identifiable problem credit or portfolio segment as of the evaluation date, management s evaluation of the inherent loss related to such condition is reflected in the unallocated allowance.

Central to our credit risk management and our assessment of appropriate loss allowance is our loan risk rating system. Under this system, the originating credit officer assigns borrowers an initial risk rating based on a thorough analysis of each borrower s financial capacity in conjunction with industry and economic trends. Approvals are made based upon the amount of inherent credit risk specific to the transaction and are reviewed for appropriateness by senior line and credit administration personnel. Credits are monitored by line and credit administration personnel for deterioration in a borrower s financial condition which may impact the ability of the borrower to perform under the contract. Although management has allocated a portion of the allowance to specific loans, specific loan pools, and off-balance sheet credit exposures (which are reported separately as part of other liabilities), the adequacy of the allowance is considered in its entirety.

It is the policy of management to maintain the allowance for loan losses at a level adequate for risks inherent in the overall loan portfolio, however, the loan portfolio can be adversely affected if the State of California s economic conditions and its real estate market in our general market area were to further deteriorate or weaken. Additionally, further weakness of a prolonged nature in the agricultural and general economy would have a negative impact on the local market. The effect of such economic events, although uncertain and unpredictable at this time, could result in an increase in the levels of nonperforming loans and additional loan losses, which could adversely affect our future growth and profitability. No assurance of the level of predicted credit losses can be given with any certainty.

Non-Accrual Loan Policy

Interest on loans is credited to income as earned and is accrued only if deemed collectible. Accrual of interest is discontinued when a loan is over 90 days delinquent or if management believes that collection is highly uncertain. Generally, payments received on nonaccrual loans are recorded as principal reductions. Interest income is recognized after all principal has been repaid or an improvement in the condition of the loan has occurred that would warrant resumption of interest accruals.

Stock-Based Compensation

The Bank recognizes in the income statement the grant-date fair value of stock options and other equity-based forms of compensation issued to employees over the employees requisite service period (generally the vesting period). The Bank uses straight-line recognition of expenses for awards with graded vesting. The Bank utilizes a binomial pricing model for all grants. Expected volatility is based on the historical volatility of the price of the Bank s stock. The Bank uses historical data to estimate option exercise and stock option forfeiture rates within the valuation model. The expected term of options granted for the binomial model is derived from applying a historical suboptimal exercise factor to the contractual term of the grant. For binomial pricing, the risk-free rate for periods is equal to the U.S. Treasury yield at the time of grant and commensurate with the contractual term of the grant.

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Other Real Estate Owned

Other real estate owned, which represents real estate acquired through foreclosure, or deed in lieu of foreclosure in satisfaction of commercial and real estate loans, is carried at the lower of cost or estimated fair value less the estimated selling costs of the real estate. The fair value of the property is based upon a current appraisal. The difference between the fair value of the real estate collateral and the loan balance at the time of transfer is recorded as a loan charge off if fair value is lower. Subsequent to foreclosure, management periodically performs valuations and the OREO property is carried at the lower of carrying value or fair value, less costs to sell. The determination of a property s estimated fair value incorporates (1) revenues projected to be realized from disposal of the property, (2) construction and renovation costs, (3) marketing and transaction costs, and (4) holding costs (e.g., property taxes, insurance and homeowners association dues). Any subsequent declines in the fair value of the OREO property after the date of transfer are recorded through a write-down of the asset. Any subsequent operating expenses or income, reduction in estimated fair values, and gains or losses on disposition of such properties are charged or credited to current operations.

Fair Value Measurements

We use fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. We base our fair values on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Securities available for sale, derivatives, and loans held for sale, if any, are recorded at fair value on a recurring basis. Additionally, from time to time, we may be required to record certain assets at fair value on a non-recurring basis, such as certain impaired loans held for investment and securities held to maturity that are other-than-temporarily impaired. These non-recurring fair value adjustments typically involve write-downs of individual assets due to application of lower-of-cost or market accounting.

We have established and documented a process for determining fair value. We maximize the use of observable inputs and minimize the use of unobservable inputs when developing fair value measurements. Whenever there is no readily available market data, Management uses its best estimate and assumptions in determining fair value, but these estimates involve inherent uncertainties and the application of Management s judgment. As a result, if other assumptions had been used, our recorded earnings or disclosures could have been materially different from those reflected in these financial statements. For detailed information on our use of fair value measurements and our related valuation methodologies, see Note 16 to the Consolidated Financial Statements in Item 8 of this Form 10-K.

Recently Issued Accounting Standards

Accounting Standards Codification. The Financial Accounting Standards Board s (FASB) Accounting Standards Codification (ASC) became effective on July 1, 2009. At that date, the ASC became FASB s officially recognized source of authoritative U.S. generally accepted accounting principles (GAAP) applicable to all public and non-public non-governmental entities, superseding existing FASB, American Institute of Certified Public Accountants (AICPA), Emerging Issues Task Force (EITF) and related literature. Rules and interpretive releases of the SEC under the authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. All other accounting literature is considered non-authoritative. The switch to the ASC affects the away companies refer to U.S. GAAP in financial statements and accounting policies. Citing particular content in the ASC involves specifying the unique numeric path to the content through the Topic, Subtopic, Section and Paragraph structure.

FASB ASC Topic 815, Derivatives and Hedging. New authoritative accounting guidance under ASC Topic 815, Derivatives and Hedging, amends prior guidance to amend and expand the disclosure requirements for derivatives and hedging activities to provide greater transparency about (i) how and why an entity uses derivative instruments, (ii) how derivative instruments and related hedge items are accounted for under ASC Topic 815, and (iii) how derivative instruments and related hedged items affect an entity s financial position, results of operations and cash flows. To meet those objectives, the new authoritative accounting guidance requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of gains and losses on derivative instruments and disclosures about credit-risk-related contingent features in derivative agreements. The new authoritative accounting guidance under ASC Topic 815 became effective for the Company on January 1, 2009 and did not have a significant impact on the Company s financial statements.

FASB ASC Topic 820, Fair Value Measurements and Disclosures. New authoritative accounting guidance under ASC Topic 820, Fair Value Measurements and Disclosures, affirms that the objective of fair value when the market for an asset is not active is the price that would be received to sell the asset in an orderly transaction, and clarifies and includes additional factors for determining whether there has been a significant decrease in market activity for an asset when the market for that asset is not active. ASC Topic 820 requires an entity to base its conclusion about whether a transaction was not orderly on the weight of the evidence. The new accounting guidance amended prior guidance to expand certain disclosure requirements. The Company adopted the new authoritative

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accounting guidance under ASC Topic 820 during the first quarter of 2009. Adoption of the new guidance did not significantly impact the Company s financial statements.

Further new authoritative accounting guidance (Accounting Standards Update No. 2009-5) under ASC Topic 820 provides guidance for measuring the fair value of a liability in circumstances in which a quoted price in an active market for the identical liability is not available. In such instances, a reporting entity is required to measure fair value utilizing a valuation technique that uses (i) the quoted price of the identical liability when traded as an asset, (ii) quoted prices for similar liabilities or similar liabilities when traded as assets, or (iii) another valuation technique that is consistent with the existing principles of ASC Topic 820, such as an income approach or market approach. The new authoritative accounting guidance also clarifies that when estimating the fair value of a liability, a reporting entity is not required to include a separate input or adjustment to other inputs relating to the existence of a restriction that prevents the transfer of the liability. The forgoing new authoritative accounting guidance under ASC Topic 820 became effective for the Company s financial statements beginning October 1, 2009 and did not have a significant impact on the Company s financial statements.

FASB ASC Topic 320, Investments - Debt and Equity Securities. New authoritative accounting guidance under ASC Topic 320, Investments - Debt and Equity Securities, (i) changes existing guidance for determining whether an impairment is other than temporary to debt securities and (ii) replaces the existing requirement that the entity s management assert it has both the intent and ability to hold an impaired security until recovery with a requirement that management assert: (a) it does not have the intent to sell the security; and (b) it is more likely than not it will not have to sell the security before recovery of its cost basis. Under ASC Topic 320, declines in the fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses to the extent the impairment is related to credit losses. The amount of the impairment related to other factors is recognized in other comprehensive income. The Company adopted the provisions of the new authoritative accounting guidance under ASC Topic 320 during the second quarter of 2009. Adoption of the new guidance did not significantly impact the Company s financial statements.

FASB ASC Topic 825 Financial Instruments. New authoritative accounting guidance under ASC Topic 825, Financial Instruments, requires an entity to provide disclosures about the fair value of financial instruments in interim financial information and amends prior guidance to require those disclosures in summarized financial information at interim reporting periods. The new interim disclosures required under Topic 825 were included in the Company s Form 10-Q beginning September 30, 2009.

FASB ASC Topic 825 Fair Value Measurements and Disclosures. In January 2010, the FASB issued ASU No. 2010-06, *Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements.* This ASU requires: (1) disclosure of the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurement categories and the reasons for the transfers; and (2) separate presentation of purchases, sales, issuances, and settlements in the reconciliation for fair value measurements using significant unobservable inputs (Level 3). In addition, ASU 2010-06 clarifies the requirements of the following existing disclosures set forth in the Codification Subtopic 820-10: (1) For purposes of reporting fair value measurement for each class of assets and liabilities, a reporting entity needs to use judgment in determining the appropriate classes of assets and liabilities; and (2) a reporting entity should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and non-recurring fair value measurements. ASU 2010-06 is effective for interim and annual reporting periods beginning January 1, 2010, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements, which are effective for fiscal years beginning January 1, 2011, and for interim periods within those fiscal years. As ASU 2010-06 is disclosure-related only, our adoption of this ASU in the first quarter of 2010 did not impact our financial condition or results of operations.

FASB ASC Topic 310 Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses. In July 2010, FASB issued Accounting Standards Update 2010-20, *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses (Topic 310).* This standard expands disclosures about credit quality of financing receivables and the allowance for loan losses.

The standard will require the Company to expand disclosures about the credit quality of our loans and the related reserves against them. The extra disclosures will include disaggregated matters related to our past due loans, credit quality indicators, and modifications of loans. The Company adopted the standard beginning with our December 31, 2010 financial statements. This standard will not have an impact on the Company s financial position or results of operations.

Results of Operations

The Company earns income from two primary sources. The first is net interest income, which is interest income generated by earning assets less interest expense on interest-bearing liabilities. The second is noninterest income, which primarily consists of deposit service charges and fees, the increase in cash surrender value of life insurance, mortgage commissions and gains on called investment securities. The majority of the Company s noninterest expenses are operating costs that relate to providing a full range of banking services to our customers.

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Overview

We recorded net income available to common shareholders for the year ended December 31, 2010 of $3,786,000 or $0.49 per diluted common share compared to $1,158,000 or $0.15 per diluted common share for the year ended December 31, 2009. The increase in net income available to common shareholders for the year ended December 31, 2010 was primarily due to a decrease of $1,842,000 in provision for loan losses, an increase in net interest income of $1,365,000, an increase in non-interest income of $128,000 and a decrease of $2,015,000 related to fair market value write downs and overhead costs of other real estate owned. Partially offsetting these factors was an increase in income tax provision of $2,150,000.

Highlights of the financial results are presented in the following table:

	As of and for the years ended December 31,		
(Dollars in thousands, except per share data)	**2010**	**2009**	**2008**
For the period:			
Net income available to common shareholders	$ 3,786	$ 1,158	$ 2,098
Net income per common share:			
Basic	$ 0.49	$ 0.15	$ 0.27
Diluted	$ 0.49	$ 0.15	$ 0.27
Return on average common equity	7.65%	2.51%	4.77%
Return on average assets	0.88%	0.38%	0.46%
Common stock dividend payout ratio	0.00%	16.54%	27.38%
Efficiency ratio	59.62%	68.04%	76.55%
At period end:			
Book value per common share	$ 6.64	$ 6.14	$ 5.81
Total assets	$ 552,396	$ 524,722	$ 508,203
Total gross loans	$ 404,194	$ 425,627	$ 428,177
Total deposits	$ 476,739	$ 429,210	$ 378,248
Net loan-to-deposit ratio	82.90%	97.34%	111.45%

Net Interest Income and Net Interest Margin

Our primary source of revenue is net interest income, which is the difference between interest and fees derived from earning assets and interest paid on liabilities obtained to fund those assets. Our net interest income is affected by changes in the level and mix of interest-earning assets and interest- bearing liabilities, referred to as volume changes. Our net interest income is also affected by changes in the yields earned on assets and rates paid on liabilities, referred to as rate changes. Interest rates charged on our loans are affected principally by the demand for such loans, the supply of money available for lending purposes and competitive factors. Those factors are, in turn, affected by general economic conditions and other factors beyond our control, such as federal economic policies, the general supply of money in the economy, legislative tax policies, the governmental budgetary matters, and the actions of the Federal Reserve Board.

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For a detailed analysis of interest income and interest expense, see the Average Balance Sheets and the Rate/Volume Analysis below.

Distribution, Yield and Rate Analysis of Net Income
For the Years Ended December 31,

	2010			2009		
	Average Balance	**Interest Income/ Expense**	**Avg Rate/ Yield**	**Average Balance**	**Interest Income/ Expense**	**Avg Rate/ Yield**
Assets:						
Earning assets:						
Gross loans (1) (2)	$ 411,590	$ 25,536	6.20%	$ 426,748	$ 26,733	6.26%
Securities of U.S. government agencies	1,552	9	0.60%	1,641	10	0.59%
Other investment securities (2)	47,669	2,597	5.45%	48,551	2,943	6.06%
Federal funds sold	8,286	19	0.23%	2,218	5	0.23%
Interest-earning deposits	17,099	42	0.25%	2,455	5	0.21%
Total interest-earning assets	486,196	28,203	5.80%	481,613	29,696	6.17%
Total noninterest earning assets	38,773			38,858		
Total Assets	$ 524,969			$ 520,471		
Liabilities and Shareholders Equity:						
Interest-bearing liabilities:						
Money market deposits	212,621	1,374	0.65%	183,314	2,455	1.34%
NOW deposits	59,617	186	0.31%	56,921	267	0.47%
Savings deposits	14,963	62	0.42%	13,851	100	0.72%
Time certificates of $100,000 or more	42,352	510	1.20%	48,912	1,156	2.36%
Other time deposits	33,383	459	1.37%	47,883	978	2.04%
Other borrowings	19,171	328	1.71%	44,071	685	1.55%
Total interest-bearing liabilities	382,107	2,919	0.76%	394,952	5,641	1.43%
Noninterest-bearing liabilities:						
Noninterest-bearing deposits	76,820			62,874		
Other liabilities	3,065			2,957		
Total noninterest-bearing liabilities	79,885			65,831		
Shareholders equity	62,977			59,688		
Total liabilities and shareholders equity	$ 524,969			$ 520,471		
Net interest income		$ 25,284			$ 24,055	
Net interest spread (3)			5.04%			4.74%
Net interest margin (4)			5.20%			4.99%

(1) Loan fees have been included in the calculation of interest income.

(2) Yields on municipal securities and loans have been adjusted to their fully-taxable equivalents (FTE), based on a federal marginal tax rate of 34.0%.

(3) Represents the average rate earned on interest-earning assets less the average rate paid on interest-bearing liabilities.

(4) Represents net interest income as a percentage of average interest-earning assets.

Net interest income, on a fully tax equivalent basis (FTE), increased $1.2 million or 5.1% to $25.3 million for the year ended December 31, 2010, compared to $24.1 million in 2009. Net interest spread and net interest margin were 5.04% and 5.20%, respectively, for the year ended December 31, 2010, compared to 4.74% and 4.99%, respectively, for the year ended December 31, 2009. The increase in the net interest margin in 2010 was attributable to these factors: 1) a significant portion of the loan portfolio is either at a fixed rate or is variable and at the contractual floors resulting in minimal downward repricing as evidenced by only a 6 basis point decrease in 2010 compared to 2009 for our total loan yield, 2) average core money market accounts grew by $29 million which

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have a lower cost than overall interest-bearing liabilities and 3) balances in time deposits and other borrowings, which are the two highest cost liabilities, decreased by $21 million and $25 million, respectively. All of these factors combined caused the rate on interest-bearing liabilities to decrease faster than the rate on earning assets. Changes in volume resulted in a decrease in net interest income (FTE) of $535,000 for the year of 2010 compared to the year 2009, and changes in interest rates and the mix resulted in an increase in net interest income (FTE) of $1,764,000 for the year 2010 versus the year 2009. Management closely monitors both total net interest income and the net interest margin.

The net interest rate spread in 2010 is consistent with 2009, reflecting a decrease of thirty-seven basis points in the yield on interest-earning assets and a decline of ninety-seven basis points in the cost of interest-bearing liabilities, reflecting a sharply declining interest rate environment. Market rate changes have a more immediate effect on deposit rates than on loan yields due to our fixed-rate loans and variable rate loans at their contractual floors. In addition, the large majority of our variable loans are tied to the U.S. Treasury Constant Maturity Indices with repricing intervals between one year to five years.

Market rates are in part based on the Federal Reserve Open Market Committee (FOMC   ) target Federal funds interest rate (the interest rate banks charge each other for short-term borrowings). The change in the Federal funds sold and purchased rates is the result of target rate changes implemented by the FOMC. In 2008, there were seven downward adjustments to the target rate totaling 325 basis points, bringing the target interest rate to a historic low with a range of 0% to 0.25% where it remained as of December 2010.

Rate/Volume Analysis

The following table below sets forth certain information regarding changes in interest income and interest expense of the Bank for the periods indicated. For each category of earning assets and interest bearing liabilities, information is provided on changes attributable to (i) changes in volume (change in average volume multiplied by old rate); and (ii) changes in rates (change in rate multiplied by old average volume). Changes in rate/volume (change in rate multiplied by the change in volume) have been allocated to the changes due to volume and rate in proportion to the absolute value of the changes due to volume and rate prior to the allocation.

Rate/Volume Analysis of Net Interest Income

	For the Year Ended December 31, 2010 vs. 2009 Increases (Decreases) Due to Change In			For the Year Ended December 31, 2009 vs. 2008 Increases (Decreases) Due to Change In		
	Volume	**Rate**	**Total**	**Volume**	**Rate**	**Total**
Interest income:						
Net loans (1)	$ (950)	$ (247)	$ (1,197)	$ 1,788	$ (2,694)	$ (906)
Securities of U.S. government agencies	(1)	0	(1)	(24)	(39)	(63)
Other Investment securities	(53)	(293)	(346)	867	476	1,343
Federal funds sold	14	0	14	15	(27)	(12)
Interest-earning deposits	31	6	37	105	(102)	3
Total interest income	(959)	(534)	(1,493)	2,751	(2,386)	365
Interest expense:						
Money market deposits	$ 393	$ (1,474)	$ (1,081)	$ 818	$ (1,940)	$ (1,122)
NOW deposits	13	(94)	(81)	20	(139)	(119)
Savings deposits	8	(46)	(38)	(28)	(130)	(158)
Time certificates of $100,000 or more	(155)	(491)	(646)	343	(764)	(421)

Other time deposits	(296)	(223)	(519)	98	(561)	(463)
Other borrowings	(387)	30	(357)	(390)	(418)	(807)
Total interest expense	(424)	(2,298)	(2,722)	861	(3,952)	(3,091)
Change in net interest income	$ (535)	$ 1,764	$ 1,229	$ 1,890	$ 1,566	$ 3,456

(1) Loan fees have been included in the calculation of interest income.

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Provision for Loan Losses

Credit risk is inherent in the business of making loans. The Bank establishes an allowance for loan losses through charges to earnings, which are shown in the statements of operations as the provision for loan losses. Specifically identifiable and quantifiable losses are promptly charged off against the allowance. The Bank maintains the allowance for loan losses at a level that it considers to be adequate to provide for credit losses inherent in its loan portfolio. Management determines the level of the allowance by performing a quarterly analysis that considers concentrations of credit, past loss experience, current economic conditions, the amount and composition of the loan portfolio (including nonperforming and potential problem loans), estimated fair value of underlying collateral, and other information relevant to assessing the risk of loss inherent in the loan portfolio such as for example loan growth, net charge-offs, changes in the composition of the loan portfolio, and delinquencies. As a result of management s analysis, a range of the potential amount of the allowance for loan losses is determined.

The provision for loan losses was $4,020,000 for the year ended December 31, 2010, compared to $5,862,000 for the year end December 31, 2009. Nonperforming loans were $11.47 million at December 31, 2010 and $14.42 million at December 31, 2009, or 2.84% and 3.39%, respectively, of total loans. Nonperforming loans are primarily in nonperforming real estate construction and development loans. The allowance for loan losses was $8.26 million and $7.02 million at December 31, 2010 and 2009, or 2.04% and 1.65%, respectively, of total loans. Net charge-offs were $2,785,000 in 2010 compared to $4,411,000 in 2009. The relatively high level of net charge-offs for 2010 and 2009 as compared to all prior years was primarily due to the economic downturn and the effect on the housing market.

The Bank will continue to monitor the adequacy of the allowance for loan losses and make additions to the allowance in accordance with the analysis referred to above. Because of uncertainties inherent in estimating the appropriate level of the allowance for loan losses, actual results may differ from management s estimate of credit losses and the related allowance.

Noninterest Income

Noninterest income was $2.77 million for the year ended December 31, 2010, compared to $2.64 million for the year 2009. In 2010, other income increased by $232,000, which was primarily attributable to an increase of $109,000 in bank debit card fees, an increase of $54,000 in rental income on banked owned properties and an increase of $26,000 from gains on called available for sale securities as compared to 2009. Service charge income was $1.07 million for the year 2010 compared to $1.16 million for the year 2009 as a result of a decrease in NSF fee income. This decrease was in spite of the increase in the aggregate number of DDA, Now, Money Market and Savings accounts of 10.3% to 20,379 at December 31, 2010 as compared to 18,476 accounts as of December 31, 2009. The Bank continues to evaluate its deposit product offerings with the intention of continuing to expand its offerings to the consumer and business depositors.

Noninterest Income

(Dollars in thousands)

	For the Years Ended December 31,			
	2010		2009	
	(Amount)	(%)	(Amount)	(%)

Service charges on deposit accounts	$	1,065	38.5%	$	1,164	44.0%
Earnings on cash surrender value of life insurance		436	15.7%		408	15.5%
Mortgaged Commissions		108	3.9%		140	5.3%
Other income		1,161	41.9%		929	35.2%
Total	$	2,770	100.00%	$	2,641	100.00%
Average assets	$	524,969		$	520,471	
Noninterest income as a % of average assets			0.5%			0.5%

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Noninterest Expense

The following table sets forth a summary of noninterest expenses for the periods indicated:

Noninterest Expense

(Dollars in thousands)

	For the Years Ended December 31,			
	2010		2009	
	(Amount)	(%)	(Amount)	(%)
Salaries and employee benefits	$ 8,457	50.4%	$ 7,781	42.7%
Occupancy expenses	2,700	16.1%	2,717	14.9%
Data processing fees	947	5.6%	894	4.9%
OREO expenses	638	3.8%	2,653	14.6%
Regulatory assessments (FDIC & DFI)	1,051	6.3%	996	5.5%
Other operating expenses	2,983	17.8%	3,177	17.4%
Total	$ 16,776	100.0%	$ 18,218	100.0%
Average assets	$ 524,969		$ 520,471	
Noninterest expenses as a % of average assets		3.2%		3.5%

Noninterest expense was $16.8 million for the year ended December 31, 2010, a decrease of $1.4 million or 7.9% compared to $18.2 million for the year ended 2009.

OREO expenses decreased by $2.01 million to $0.64 million in 2010, compared to $2.65 million in 2009 due to decreased market value write-downs on owned properties and the overhead costs associated with carrying those properties.

Other expenses recognized a decrease in 2010 compared to 2009 of $194,000 as our core operations remained stable and management remains committed to improving operating efficiency.

Occupancy expenses in 2010 were relatively flat at $2.70 million compared to $2.72 in 2009. The slight decrease was primarily due to a decrease in the depreciation expense of building, furnishings and equipment fixed assets.

FDIC and DFI (California Department of Financial Institutions) regulatory assessments increased by $55,000 to $1,051,000 in 2010 compared to $996,000 in 2009. The increase in FDIC insurance was due to a higher deposit base in 2010 as compared to 2009, as the FDIC assessment rates are applied to average quarterly deposits. Effective April 1, 2009, the FDIC adopted a final rule revising its risk-based insurance assessment system and effectively increasing the overall assessment rate. The new initial base assessment rates for Risk Category 1 institutions range from twelve to sixteen basis points, on an annualized basis. The increase in 2010 was due in part to these industry-wide increased FDIC base assessment rates applied for the full year, as opposed to half of the year in 2009. In addition, we continued to participate in the FDIC Transaction Account Guarantee Program, which provided unlimited insurance coverage on non-interest-bearing transaction accounts defined by the FDIC, on which we paid a 10 basis point surcharge per $100 covered balances in excess of $250 thousand in 2009 and a 20 basis point surcharge in 2010.

Offsetting these decreases was an increase in salaries and employee benefits of $676,000 as a result of hiring to fill existing positions, increased group health insurance benefits and a decrease in deferred loan costs.

Data processing costs increased in 2010 over 2009 by $53,000, reflecting the additional costs that related to the increased number of deposit accounts.

Management anticipates that noninterest expense will continue to increase as we continue to grow, even though management also estimates that the Bank s administration as currently set up may be scalable to handle a larger deposit base of up to around $1B in deposits. However, management remains committed to cost-control and efficiency, and we expect to keep these increases to a minimum relative to growth.

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Provision for Income Taxes

We reported a provision for income taxes of $2,353,000, and $203,000 for the years 2010 and 2009 respectively. The effective income tax rate on income from continuing operations was 33.7% for the year ended December 31, 2010 compared to 9.2% for the year 2009. These provisions reflect accruals for taxes at the applicable rates for federal income tax and California franchise tax based upon reported pre-tax income, and adjusted for the effects of all permanent differences between income for tax and financial reporting purposes (such as earnings on qualified municipal securities, BOLI and certain tax-exempt loans). The disparity between the effective tax rates in 2010 as compared to 2009 is primarily due to tax credits from California Enterprise Zones and low income housing projects as well as tax free-income on loans within these enterprise zones and municipal securities and loans that comprise a larger proportion of pre-tax income in 2009 as compared to 2010. We have not been subject to an alternative minimum tax (AMT) during these periods.

Financial Condition

The Bank s total assets were $552.4 million at December 31, 2010 compared to $524.7 million at December 31, 2009, an increase of $27.7 million or 5.3%. Net loans decreased $22.6 million, investments increased $2.5 million, bank premises and equipment remained flat at $10.2 million and interest receivable and other assets increased $1.8 million, while cash and cash equivalents increased $47.3 million.

Loans gross of the allowance for loan losses and deferred fees were $404.2 million at December 31, 2010, compared to $425.6 million at December 31, 2009, a decrease of $21.4 million or 5.0%. The decrease was primarily due to a decrease of $16.4 million or 4.7% in the commercial real estate, a decrease of $7.4 million in commercial and industrial loans and a decrease of $109,000 in consumer loans. These were offset by increases of $1.7 million and $0.8 million in consumer residential and agriculture loans, respectively. The composition of the loan portfolio categories remained relatively unchanged as a percentage of total loans, except for commercial and industrial loans which recognized the highest change from 9.0% at December 31, 2009 to 7.6% at December 31, 2010.

Deposits increased $47.5 million or 11.1% to $476.7 million at December 31, 2010 compared to $429.2 million at December 31, 2009. All deposit types increased except for time deposits which decreased by $8.9 million. All other deposits increased, including demand deposit accounts which recognized a $32.8 million increase. Money market, NOW and Savings each increased by $18.9 million, $3.6 million and $1.1 million, respectively.

Short-term borrowings decreased $22.2 million to $5.0 million at December 31, 2010, compared to $27.2 million at December 31, 2009 and long-term debt decreased to $3.0 million at December 31, 2010, compared to $5.0 million at December 31, 2009. The decrease in short-term and long-term debt was due to the deposit growth of $48 million. This allowed us to pay off matured FHLB advances thus reducing our cost of funds and improving our liquidity ratio. The Bank uses short-term borrowings, primarily short-term FHLB advances, to fund short-term liquidity needs and manage net interest margin.

Equity increased $4.0 million or 6.5% to $64.7 million at December 31, 2010, compared to $60.7 million at December 31, 2009. The Bank was selected to participate in the U.S. Treasury Capital Purchase Program (TCPP) which resulted in the issuance of $13.5 million in preferred stock in December 2008. The Bank intends to use the capital to increase credit availability to local, creditworthy, businesses and consumers. The preferred stock shares have a 5% coupon for 5 years and 9% thereafter. Warrants to purchase 350,346 shares of common stock at a per share exercise price of $5.78 are attached and fully exercisable. The warrants expire 10 years after the issuance date. The securities issued to the Treasury will be accounted for as components of regulatory Tier 1 capital. See Note 12 to the Consolidated Financial Statements in Item 8 of this report for further discussion regarding our participation in the TCPP.

Investment Activities

Investments are a key source of interest income. Management of our investment portfolio is set in accordance with strategies developed and overseen by our Investment Committee. Investment balances, including cash equivalents and interest-bearing deposits in other financial institutions, are subject to change over time based on our asset/liability funding needs and interest rate risk management objectives. Our liquidity levels take into consideration anticipated future cash flows and all available sources of credits and are maintained at levels management believes are appropriate to assure future flexibility in meeting anticipated funding needs.

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Cash Equivalents and Interest-bearing Deposits in other Financial Institutions

The Bank holds federal funds sold, unpledged available-for-sale securities and salable government guaranteed loans to help meet liquidity requirements and provide temporary holdings until the funds can be otherwise deployed or invested. As of December 31, 2010, and 2009, we had $40.8 million and $1.6 million, respectively, in federal funds sold.

Investment Securities

Management of our investment securities portfolio focuses on providing an adequate level of liquidity and establishing an interest rate-sensitive position, while earning an adequate level of investment income without taking undue risk. Investment securities that we intend to hold until maturity are classified as held-to-maturity securities, and all other investment securities are classified as available-for-sale. Currently, all of our investment securities are classified as available-for-sale. The carrying values of available-for-sale investment securities are adjusted for unrealized gains or losses as a valuation allowance and any gain or loss is reported on an after-tax basis as a component of other comprehensive income.

Our investment securities holdings increased by $2.5 million, or 4.9%, to $53.3 million at December 31, 2010, compared to holdings of $50.8 million at December 31, 2009. Total investment securities as a percentage of total assets decreased to 9.6% as compared to 9.7% at December 31, 2009. As of December 31, 2010, $46.4 million of the investment securities were pledged to secure certain deposits.

As of December 31, 2010, the total unrealized loss on securities that were in a loss position for less than 12 continuous months was $67,000 with an aggregate fair value of $4,518,000. The total unrealized loss on securities that were in a loss position for greater than 12 continuous months was $11,000 with an aggregate fair value of $1,499,000.

The following table summarizes the book value and market value and distribution of our investment securities as of the dates indicated:

Investment Securities Portfolio

	As of December 31, 2010		As of December 31, 2009		As of December 31, 2008	
Dollars in Thousands	**Amortized Cost**	**Market Value**	**Amortized Cost**	**Market Value**	**Amortized Cost**	**Market Value**
Available-for-Sale:						
Securities of U.S. government agencies	$ 28,679	$ 30,190	$ 29,475	$ 30,985	$ 25,541	$ 26,085
Collateralized mortgage obligations	7,947	8,137	2,885	2,995	3,439	3,485
Municipal securities	9,871	10,800	12,328	13,557	9,971	9,902
SBA Pools	1,517	1,506	1,589	1,579	1,820	1,779

Asset Backed Security		0		0		82		83		198		198
Mutual Fund		2,631		2,635		1546		1566		0		0
Total investment securities	$	50,645	$	53,268	$	47,905	$	50,765	$	40,969	$	41,449

At December 31, 2010, two SBA pools make up the total amount of securities in an unrealized loss position for greater than 12 months. Management periodically evaluates each available-for-sale investment security in an unrealized loss position to determine if the impairment is temporary or other than temporary. Management has determined that no investment security is other than temporarily impaired. The unrealized losses are due solely to interest rate changes and the Bank does not intend to sell the securities and it is not likely that we will be required to sell the securities before the earlier of the forecasted recovery or the maturity of the underlying investment security. As of December 31, 2010, we did not have any investment securities that constituted 10% or more of the stockholders equity of any third party issuer.

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The following table summarizes the maturity and repricing schedule of our investment securities at their amortized cost and their weighted average yields at December 31, 2010:

Investment Maturities and Repricing Schedule

(Dollars in Thousands)

	Within One Year		After One But Within Five Years		After Five But Within Ten Years		After Ten Years		Total	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
Available-for-sale:										
Securities of U.S. government agencies	$ 0	0.00%	$ 3,175	3.08%	$ 13,695	4.72%	$ 11,809	4.93%	$ 28,679	4.63%
Collateralized mortgage obligations	0	0.00%	0	0.00%	0	0.00%	7,947	4.21%	7,947	4.21%
Municipal securities	1,025	4.98%	2,476	5.20%	5,285	5.71%	1,084	5.94%	9,871	8.92%
SBA Pools	0	0.00%	0	0.00%	0	0.00	1,517	0.58%	1,517	0.58%
Mutual Fund	0	0.00%	0	0.00%	0	0.00%	2,632	0.00%	2,631	0.00%
Total Investment Securities	$ 1,025	4.98%	$ 5,651	4.01%	$ 18,980	5.00%	$ 24,989	3.96%	$ 50,645	4.38%

Interest income and yields in the above table have not been adjusted to a fully tax equivalent basis.

Loans

The following table sets forth the amount of total loans outstanding (excluding unearned income) and the percentage distributions in each category, as of the dates indicated.

	YEARS ENDED DECEMBER 31,				
	2010	2009	2008	2007	2006
Commercial real estate	$ 336,730	$ 353,171	$ 354,401	$ 303,723	$ 304,526
Commercial and Industrial	30,756	38,160	37,302	45,497	41,077
Consumer	1,242	1,351	1,281	1,414	1,607
Consumer residential	21,844	20,117	21,613	17,986	14,803
Agriculture	13,622	12,828	13,580	19,189	16,380
Unearned income	(733)	(811)	(1,035)	(1,038)	(1,233)
Total Loans, net of unearned income	$ 403,461	$ 424,816	$ 427,142	$ 386,771	$ 377,160
Participation loans sold and serviced by the Bank	9,283	14,907	9,759	1,314	3,488
Commercial real estate	83.5%	83.1%	83.0%	78.5%	80.7%
Commercial and Industrial	7.6%	9.0%	8.7%	11.8%	10.9%

Consumer	0.3%	0.3%	0.3%	0.4%	0.4%
Consumer residential	5.4%	4.7%	5.1%	4.7%	3.9%
Agriculture	3.4%	3.0%	3.2%	5.0%	4.3%
Unearned income	(0.2)%	(0.2)%	(0.2)%	(0.3)%	(0.3)%
Total Loans, net of unearned income	100.0%	100.0%	100.0%	100.0%	100.0%

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Commercial real estate loans decreased $16.4 million in 2010 as compared to 2009, as a result of the decline in demand by qualified borrowers in our serving area. Of the commercial real estate loans at December 31, 2010, 62.5% are non-owner occupied and 37.5% are owner occupied. Our commercial real estate loan portfolio is weighted towards term loans for which the primary source of repayment is cash flow from net operating income of the real estate property.

Commercial and industrial loan decrease of $7.4 million in 2010 as compared to 2009 was the result of our reassessment of the commercial and industrial lending market, specifically asset-based lines of credit. We have historically targeted well-established local businesses with strong guarantors that have proven to be resilient in periods of economic stress.

Our residential loan portfolio includes no sub-prime loans, nor is it our normal practice to underwrite loans commonly referred to as Alt-A mortgages , the characteristics of which are loans lacking full documentation, borrowers having low FICO scores or collateral compositions reflecting high loan-to-value ratios. However, substantially all of our residential loans are indexed to Treasury Constant Maturity Rates and have provisions to reset five years after their origination dates.

The following table summarizes our commercial real estate loan portfolio by the geographic location in which the property is located as of December 31, 2010 and 2009:

Commercial Real Estate Loans Outstanding by Geographic Location

	December 31, 2010		December 31, 2009	
Commercial real estate loans by geographic location (County)	**Amount**	**% of Commercial Real Estate Loans**	**Amount**	**% of Commercial Real Estate Loans**
Stanislaus	$ 148,562	44.1%	$ 159,617	45.2%
San Joaquin	58,248	17.3%	59,469	16.8%
Tuolumne	26,222	7.8%	26,161	7.4%
Mono	18,208	5.4%	22,732	6.4%
Sacramento	11,376	3.4%	11,586	3.3%
Alameda	10,653	3.2%	12,075	3.4%
Inyo	9,514	2.8%	10,191	2.9%
Merced	8,911	2.6%	9,055	2.6%
Fresno	8,640	2.6%	4,667	1.3%
Madera	7,318	2.2%	7,526	2.1%
Los Angeles	6,247	1.9%	6,480	1.8%
Contra Costa	6,076	1.8%	1,846	0.5%
Tulare	3,951	1.2%	4,005	1.1%
Marin	3,937	1.2%	3,977	1.1%
Santa Clara	3,904	1.1%	4,907	1.5%
Other	4,963	1.4%	8,877	2.6%
Total	**$ 336,730**	**100.0%**	**$ 353,171**	**100.0%**

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Construction loans decreased $20.3 million in 2010 as compared to 2009, primarily due to the successful completion and sell-through of construction development projects booked in prior years, a slow down in construction activity (primarily residential development), as well as a conscious effort to reduce our concentration in construction loans. The table below shows an analysis of construction loans by type and location. Non-owner-occupied land loans of $17.7 million at December 31, 2010 included loans for lands specified for commercial development of $5.7 million and for residential development of $12.0 million, the majority of which are located in Stanislaus County.

Construction Loans Outstanding by Type and Geographic Location

	December 31, 2010			December 31, 2009		
Construction loans by type		**Amount**	**% of Construction Loans**		**Amount**	**% of Construction Loans**
Single family non-owner-occupied	$	2,663	8.2%	$	7,860	14.8%
Single family owner-occupied		1,342	4.1%		761	1.4%
Commercial non-owner-occupied		8,217	25.2%		10,867	20.5%
Commercial owner-occupied		1,448	4.4%		8,217	15.5%
Land non-owner-occupied		17,699	54.2%		22,078	41.8%
Land owner-occupied		1,276	3.9%		3,169	6.0%
Total	$	**32,645**	**100.0%**	$	**52,952**	**100.0%**

Construction loans by geographic location (County)		**Amount**	**% of Construction Loans**		**Amount**	**% of Construction Loans**
Stanislaus	$	13,984	42.8%	$	17,271	32.6%
Fresno		8,217	25.2%		4,236	8.0%
Mono		6,814	20.9%		10,814	20.4%
Contra Costa		1,539	4.7%		774	1.5%
Tuolumne		913	2.8%		4,821	9.1%
Tulare		736	2.2%		750	1.4%
Inyo		414	1.3%		587	1.1%
Madera		0	0.0%		7,525	14.2%
San Joaquin		0	0.0%		5,134	9.7%
Other		28	0.1%		1,040	2.0%
Total	$	**32,645**	**100.0%**	$	**52,952**	**100.0%**

Loan Maturities

The following table shows the contractual maturity distribution and repricing intervals of the outstanding loans in our portfolio, as of December 31, 2010. In addition, the table shows the distribution of such loans between those with variable or floating interest rates and those with fixed or predetermined interest rates. The large majority of the variable rate loans are tied to independent indices (such as the Wall Street Journal prime rate or a Treasury Constant Maturity Rate). Substantially all loans with an original term of more than five years have provisions for the fixed rates to reset, or convert to a variable rate, after one, three or five years.

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	Loan Maturities and Repricing Schedule At December 31, 2010			
(Dollars in thousands)	Within One Year	After One But Within Five Years	After Five Years	Total
Commercial real estate	$ 98,007	$ 184,161	$ 54,562	$ 336,730
Commercial & Industrial	16,535	13,087	1,134	30,756
Consumer	620	622	0	1,242
Consumer Residential	1,354	6,469	14,021	21,844
Agriculture	10,793	1,066	1,763	13,622
Unearned income	(231)	(373)	(129)	(733)
Total loans, net of unearned income	$ 127,078	$ 205,032	$ 71,351	$ 403,461
Loans with variable (floating) interest rates	$ 99,652	$ 167,747	$ 38,993	$ 306,392
Loans with predetermined (fixed) interest rates	$ 27,426	$ 37,285	$ 32,358	$ 97,069

The majority of the properties taken as collateral are located in Northern California. We employ strict guidelines regarding the use of collateral located in less familiar market areas. The recent decline in Northern California real estate value is offset by the low loan-to-value ratios in our commercial real estate portfolio and high percentage of owner-occupied properties.

Nonperforming Assets

Financial institutions generally have a certain level of exposure to credit quality risk, and could potentially receive less than a full return of principal and interest if a debtor becomes unable or unwilling to repay. Since loans are the most significant assets of the Company and generate the largest portion of its revenues, the Company s management of credit quality risk is focused primarily on loan quality. Banks have generally suffered their most severe earnings declines as a result of customers inability to generate sufficient cash flow to service their debts and/or downturns in national and regional economies which have brought about declines in overall property values. In addition, certain debt securities that the Company may purchase have the potential of declining in value if the obligor s financial capacity to repay deteriorates.

Nonperforming assets consist of loans on non-accrual status, loans 90 days or more past due and still accruing interest, loans restructured, where the terms of repayment have been renegotiated resulting in a reduction or deferral of interest or principal and other real estate owned (OREO).

Loans are generally placed on non-accrual status when they become 90 days past due, unless management believes the loan is adequately collateralized and in the process of collection. The past due loans may or may not be adequately collateralized, but collection efforts are continuously pursued. Loans may be restructured by management when a borrower has experienced some changes in financial status, causing an inability to meet the original repayment terms, and where we believe the borrower will eventually overcome those circumstances and repay the loan in full. OREO consists of properties acquired by foreclosure or similar means and which management intends to offer for sale.

The Bank had nonperforming loans of $11.48 million at December 31, 2010, as compared to $14.42 million at December 31, 2009, $4.08 million at December 31, 2008, $9.81 million at December 31, 2007 and no nonperforming loans at December 31, 2006. The ratio of nonperforming loans over total loans was 2.84%, 3.39%, 1.10%, 2.54% and 0.00% at December 31, 2010, 2009, 2008, 2007 and 2006, respectively.

In addition, the Bank held three OREO properties with a market value of $0.8 million as of December 31, 2010 as compared with 6 properties with a market value of $2.1 million as of December 31, 2009 and two properties with a market value of $2.7 million at December 31, 2008. The Bank did not possess any OREO during any of the year-end periods of 2006 through 2007.

Management believes that the reserve provided for nonperforming loans, together with the tangible collateral, were adequate as of December 31, 2010. See Allowance for Loan Losses below for further discussion. Except as disclosed above, as of

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December 31, 2010, management was not aware of any material credit problems of borrowers that would cause it to have serious doubts about the ability of a borrower to comply with the present loan payment terms. However, no assurance can be given that credit problems may exist that may not have been brought to the attention of management, or that credit problems may arise.

The following table provides information with respect to the components of our nonperforming assets as of the dates indicated. (The figures in the table are net of the portion guaranteed by the U.S. Government):

Nonperforming Assets

(Dollars in Thousands)			At December 31, 2010		
	2010	2009	2008	2007	2006
Nonaccrual loans(1)					
Commercial real estate	$ 11,253	$ 12,701	$ 4,078	$ 9,087	$ 0
Commercial and industrial	222	488	0	0	0
Consumer	0	0	0	0	0
Consumer residential	0	0	0	0	0
Agriculture	0	1,229	0	0	0
Total	$ 11,475	$ 14,418	$ 4,078	9,087	$ 0
Loans 90 days or more past due and still accruing (as to principal or interest):					
Commercial real estate	$ 0	$ 0	$ 643	$ 721	$ 0
Commercial and industrial	0	0	0	0	0
Consumer	0	0	0	0	0
Consumer residential	0	0	0	0	0
Agriculture	0	0	0	0	0
Total	0	0	643	721	0
Restructured loans(2)					
Commercial real estate	$ 0	$ 0	$ 0	$ 0	$ 0
Commercial and industrial	0	0	0	0	0
Consumer	0	0	0	0	0
Consumer residential	0	0	0	0	0
Agriculture	0	0	0	0	0
Total	0	0	0	0	0
Total nonperforming loans	11,475	14,418	4,721	9,808	0
Other real estate owned	778	2,150	2,746	0	0
Total nonperforming assets	$ 12,253	$ 16,568	$ 7,467	$ 9,808	$ 0
Nonperforming loans as a percentage of total loans	2.84%	3.39%	1.10%	2.54%	0.00
Nonperforming assets as a percentage of total loans and other real estate owned	3.03%	3.88%	1.74%	2.54%	0.00
Allowance for loan losses as a percentage of nonperforming loans	71.94%	48.69%	117.97%	45.95%	

(1) During the fiscal year ended December 31, 2010 and 2009, no interest income related to these loans was included in net income while on nonaccrual status. Additional interest income of approximately $818,000 and $457,000 would have been recorded during the year ended December 31, 2010 and 2009, respectively, if these loans had been paid in accordance with their original terms.

(2) A restructured loan is one the terms of which were renegotiated to provide a reduction or deferral of interest or principal because of deterioration in the financial position of the borrower.

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Allowance for Loan Losses

In anticipation of credit risk inherent in our lending business, we set aside allowances through charges to earnings. Such charges are not only made for the outstanding loan portfolio, but also for off-balance sheet items, such as commitments to extend credits or letters of credit. The charges made for the outstanding loan portfolio are credited to the allowance for loan losses, whereas charges for off-balance sheet items are credited to the reserve for off-balance sheet items, which is presented as a component of other liabilities. The provision for loan losses is discussed in the section entitled Provision for Loan Losses above.

The balance of our allowance for loan losses is Management s best estimate of the remaining losses inherent in the portfolio. The ultimate adequacy of the allowance is dependent upon a variety of factors beyond our control, including the real estate market, changes in interest rate and economic and political environments.

The current stagnant economic condition combined with growth of our loan portfolio in the past five years has required more reserves for probable loan losses. The allowance for loan losses increased by 17.6%, or $1,235,000, to $8.26 million at December 31, 2010, as compared with $7.02 million at December 31, 2009. Such allowances were $5.57 million, $4.51 million and $4.34 million at December 31, 2008, 2007 and 2006, respectively. Due to loan growth and the current economic downturn s effect on the financial stability of certain borrowers, the loan loss allowances have increased to maintain an adequate reserve as a percentage of total loans, as reflected in the ratios of 2.04%, 1.65%, 1.30%, 1.16% and 1.15%, at the end of 2010, 2009, 2008, 2007 and 2006, respectively. Based on the current conditions of the loan portfolio, Management believes that the $8.26 million allowance for loan losses at December 31, 2010 is adequate to absorb losses inherent in our loan portfolio. No assurance can be given, however, that adverse economic conditions or other circumstances will not result in increased losses in the portfolio.

In light of the current weakness in the economic environment, and specifically in the real estate construction sector, reserves have been increased to recognize such increased risk. Diversification, low loan-to-values, strong credit quality and enhanced credit monitoring contribute to a reduction in the portfolio s overall risk, and help to offset the economic risk. The impact of the increasing economic weakness will continue to be monitored, and adjustments to the provision for loan loss will be made accordingly. As evidenced in 2010, the weak business climate adversely impacted the financial conditions of some of our clients and increased our net loan charge-off to $2,785,000, compared to $4,411,000, $1,110,000, $397,000 and $13,000 in 2009, 2008, 2007 and 2006, respectively.

Management reviews these conditions with our senior credit officers. To the extent that any of these conditions is evidenced by a specifically identifiable problem credit or portfolio segment as of the evaluation date, management s estimate of the effect of such condition may be reflected as a specific allowance applicable to such credit or portfolio segment. Where any of these conditions is not evidenced by a specific, identifiable problem credit or portfolio segment as of the evaluation date, management s evaluation of the inherent loss related to such condition is reflected in the unallocated allowance. Although management has allocated a portion of the allowance to specific loan categories, the adequacy of the allowance is considered in its entirety.

Although management believes the allowance at December 31, 2010 was adequate to absorb losses from any known and inherent risks in the portfolio, no assurance can be given that economic conditions which adversely affect our service areas or other variables will not result in increased losses in the loan portfolio in the future.

As of December 31, 2010, our allowance for loan losses consisted of amounts allocated to three phases of our methodology for assessing loan loss allowances, as follows (see details of methodology for assessing allowance for loan losses in the section entitled Critical Accounting Policies):

	Years Ended December 31,		
Phase of Methodology (Dollars in Thousands)	**2010**	**2009**	**2008**
Specific review of individual loans	$ 948	$ 1,256	$ 769
Review of pools of loans with similar characteristics	$ 5,392	$ 3,808	$ 2,939
Judgmental estimate based on various subjective factors	$ 1,915	$ 1,956	$ 1,861

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The Components of the Allowance for Loan Losses

As stated previously in Critical Accounting Policies, the overall allowance consists of a specific allowance for individually identified impaired loans, an allowance factor for categories of credits with similar characteristics and trends, and an allowance for changing environmental factors.

The first component, the specific allowance, results from the analysis of identified problem credits and the evaluation of sources of repayment including collateral, as applicable. Through Management s ongoing loan grading process, individual loans are identified that have conditions that indicate the borrower may be unable to pay all amounts due under the contractual terms. These loans are evaluated individually by Management and specified allowances for loan losses are established when the discounted cash flows of future payments or collateral value of collateral-dependent loans are lower than the recorded investment in the loan. Generally with problem credits that are collateral-dependent, we obtain appraisals of the collateral at least annually. We may obtain appraisals more frequently if we believe the collateral value is subject to market volatility, if a specific event has occurred to the collateral (e.g. tentative map has been filed), or if we believe foreclosure is imminent. Impaired loan balances decreased from $14.4 million at December 31, 2009 to $11.5 million at December 31, 2010. The specific allowance totaled $948,000 and $1,256,000 at December 31, 2010 and 2009, respectively, as we charge off substantially all of our estimated losses related to specifically identified impaired loans as the losses are identified.

The second component, the allowance factor, is an estimate of the probable inherent losses in each loan pool stratified by major categories or loans with similar characteristics in our loan portfolio. This analysis encompasses segmenting and reviewing loan grades by pool and current general economic and business conditions. Confirmation of the quality of our grading process is obtained by independent reviews conducted by consultants specifically hired for this purpose and by various bank regulatory agencies. This analysis covers our entire loan portfolio but excludes any loans that were analyzed individually for specific allowances as discussed above. There are limitations to any credit risk grading process. The number of loans makes it impractical to review every loan every quarter. Therefore, it is possible that in the future some currently performing loans not recently graded will not be as strong as their last grading and an insufficient portion of the allowance will have been allocated to them. Grading and loan review often must be done without knowing whether all relevant facts are at hand. Troubled borrowers may deliberately or inadvertently omit important information from reports or conversations with lending officers regarding their financial condition and the diminished strength of repayment sources.

The total amount allocated for the second component is determined by applying loss estimation factors to outstanding loans. At December 31, 2010 and 2009, the allowance allocated by categories of credits totaled $5.4 million and $3.8 million, respectively. The increase mainly related to increased allowance factors for land loans related to the construction of residential subdivisions, commercial quick-qualifier loans and manufactured home loans, recognizing increased risk for these types of loans, as well as loan growth.

The third component of the allowance for loan losses is an economic component that is not allocated to specific loans or groups of loans, but rather is intended to absorb losses caused by portfolio trends, concentration of credit, growth, and economic trends, as stated previously in Critical Accounting Policies . At December 31, 2010 and 2009, the general valuation allowance, including the economic component, totaled $1.9 million and $2.0 million, respectively. Starting in late 2008, we witnessed financial difficulties experienced by borrowers in our market, where real estate sale prices have declined and holding periods have increased. The U.S. economy is still experiencing significantly reduced business activity as a result of, among other factors, disruptions in the financial system, dramatic declines in the housing prices, and an increasing unemployment rate. There have been significant reductions in spending by consumers and businesses. In response to this, we have been proactive in evaluating reserve percentages for economic and other qualitative loss factors used to determine the adequacy of the allowance for loan losses. The increase to the third component of the allowance for loan losses reflected such evaluation.

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The table below summarizes, for the periods indicated, loan balances at the end of each period, the daily averages during the period, changes in the allowance for loan losses arising from loans charged off, recoveries on loans previously charged off, additions to the allowance and certain ratios related to the allowance for loan losses:

Allowance for Loan Losses

(in thousands)

	2010	2009	2008	2007	2006
Balances:					
Average total loans outstanding during period	$ 411,590	$ 426,748	$ 400,821	$ 381,316	$ 345,063
Total loans outstanding at end of period	404,194	$ 425,627	$ 428,177	$ 386,771	$ 377,160
Allowance for loan losses:					
Balances at beginning of period	$ 7,020	$ 5,569	$ 4,507	$ 4,341	$ 3,976
Actual charge-offs:					
Commercial real estate	2,696	3,524	1,062	366	0
Commercial and Industrial	52	871	11	0	0
Consumer	1	0	0	0	0
Consumer Residential	43	24	42	35	15
Agriculture	0	0	0	0	0
Total charge-offs	2,792	4,419	1,115	402	15
Recoveries on loans previously charged off:					
Commercial real estate	0	0	0	0	0
Commercial and Industrial	2	0	0	0	0
Consumer	5	0	0	0	0
Consumer Residential	0	8	5	5	2
Agriculture	0	0	0	0	0
Total recoveries	7	8	5	5	2
Net loan charge-offs	2,785	4,411	1,110	397	13
Provision for loan losses	4,020	5,862	2,188	555	595
Reclassification of reserve related to off-balance-sheet commitments	0	0	(16)	8	(217)
Balance at end of period	$ 8,255	$ 7,020	$ 5,569	$ 4,507	$ 4,341
Ratios:					
Net loan charge-offs to average total loans	0.68%	1.03%	0.28%	0.10%	0.00%
Allowance for loan losses to total loans at end of period	2.04%	1.65%	1.30%	1.16%	1.15%
Net loan charge-offs to allowance for loan losses at end of period	33.74%	62.83%	19.93%	8.81%	0.29%
Net loan charge-offs to provision for loan losses	69.28%	75.25%	50.73%	71.57%	2.12%

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The table below summarizes, for the periods indicated, the balance of the allowance for loan losses and the percentage of each type of loan balance at the end of each period (See Loan Portfolio above for a description of each type of loan balance):

Allocation of the Allowance for Loan Losses

	Amount Outstanding as of December 31,				
	2010	2009	2008	2007	2006
			(Dollars in Thousands)		
Applicable to:					
Commercial real estate	$ 6,577	$ 5,845	$ 4,364	$ 3,403	$ 3,683
Commercial and Industrial	686	649	732	642	420
Consumer	61	44	34	25	28
Consumer Residential	375	202	193	117	100
Agriculture	153	142	127	183	164
Unallocated	403	138	119	137	(54)
Total Allowance	$ 8,255	$ 7,020	$ 5,569	$ 4,507	$ 4,341

Other Earning Assets

For various business purposes, we make investments in earning assets other than the interest-earning securities discussed above. Before 2007, the only other earning assets held by us were insignificant amounts of Federal Home Loan Bank stock, Federal Reserve Bank stock and the cash surrender value on the Bank Owned Life Insurances (BOLI). Balances of the Federal Home Loan Bank stock, Federal Reserve Bank stock and the BOLI cash surrender value as of December 31, 2010 were $3.4 million, $1.2 million and $11.1 million, respectively.

During 2007, we invested in a low-income housing tax credit funds (LIHTCF) to promote our participation in CRA activities. We committed to invest $1 million, over the next two to three years. We anticipate receiving the return following this two to three year period in the form of tax credits and tax deductions over the next fifteen years.

The balances of other earning assets as of December 31, 2010 and December 31, 2009 were as follows:

Dollars in Thousands	Balance as of December 31, 2010	Balance as of December 31, 2009
Type		
BOLI	$ 11,099	$ 10,268
LIHTCF	$ 703	$ 769
Federal Reserve Bank Stock	$ 1,159	$ 1,157
Federal Home Loan Bank Stock	$ 3,381	$ 3,804

Deposits and Other Sources of Funds

Deposits

Total deposits at December 31, 2010, and 2009 were $476.7 million, and $429.2 million, respectively, representing an increase of $47.5 million or 11.1%, in 2010. The average deposits for the years ended December 31, 2010 increased $26.0 million or 6.3% to $439.8 million compared to $413.8 million at December 31, 2009.

Deposits are the Bank s primary source of funds. Due to strategic emphasis by management, core deposits (based on definition provided by FDIC s UBPR) increased by 12.6% in 2010 to $431.8 million at December 31, 2010. As a result, the percentage of core deposits to total deposits increased to 90.1% at December 31, 2010 as compared to 89.3% at December 31, 2009. The average rate paid on time deposits in denominations of $100,000 or more was 1.37% and 2.36% for the years ended December 31,

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2010 and 2009, respectively. The composition and cost of the Company s deposit base are important components in analyzing the Company s net interest margin and balance sheet liquidity characteristics, both of which are discussed in greater detail in other sections herein. See Net Interest Income and Net Interest Margin for further discussion.

The Company s liquidity is impacted by the volatility of deposits or other funding instruments or, in other words, by the propensity of that money to leave the institution for rate-related or other reasons. Deposits can be adversely affected if economic conditions in California and the Company s market area in particular, continue to weaken. Potentially, the most volatile deposits in a financial institution are jumbo certificates of deposit, meaning time deposits with balances that equal or exceed $100,000, as customers with balances of that magnitude are typically more rate-sensitive than customers with smaller balances

The following tables summarize the distribution of average daily deposits and the average daily rates paid for the periods indicated:

Distribution of Average Daily Deposits

(Dollars in Thousands)

	Average Deposits					
	2010		2009		2008	
Dollars in Thousands	**Average Balance**	**Average Rate**	**Average Balance**	**Average Rate**	**Average Balance**	**Average Rate**
Demand, noninterest-bearing	$ 76,820	0.00%	$ 62,874	0.00%	$ 61,554	0.00%
Money market	212,621	0.65%	183,314	1.34%	149,202	2.40%
NOW	59,617	0.31%	56,921	0.47%	54,160	0.71%
Savings	14,963	0.42%	13,851	0.72%	15,563	1.66%
Time certificates of deposit of $100,000 or more	42,352	1.20%	48,912	2.36%	40,172	3.92%
Other time deposits	33,383	1.37%	47,883	2.04%	44,846	3.21%
Total deposits	$ 439,756	0.58%	$ 413,755	1.20%	$ 365,497	1.98%

The scheduled maturities of our time deposits in denominations of $100,000 or greater at December 31, 2010 are, as follows:

Maturities of Time Deposits of $100,000 or More

(Dollars in Thousands)

Three months or less	$ 15,081
Over three months through six months	4,172
Over six months through twelve months	12,127
Over twelve months	13,770
Total	$ 45,150

Because our client base is comprised primarily of commercial and industrial accounts, individual account balances are generally higher than those of consumer-oriented banks. Five of our clients carry deposit balances of more than 1% of our total deposits, one of which had a deposit balance of more than 3% of total deposits at December 31, 2010.

The only brokered deposit the Bank holds are from CDARS, a certificate of deposit program that exchanges funds with other network banks to offer full FDIC insurance coverage to the customer. The Bank had $3.8 million and $11.4 million in brokered deposits as of December 31, 2010 and 2009, respectively.

FHLB Borrowings

Although deposits are the primary source of funds for our lending and investment activities and for general business purposes, we may obtain advances from the Federal Home Loan Bank of San Francisco (FHLB) as an alternative to retail deposit

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funds. Our outstanding FHLB advances decreased by $24.2 million to $8.0 million at year-end 2010 compared to the prior year as a result of our emphasis on managing non-relationship, high cost CDs. See Liquidity Management below for the details on the FHLB borrowings program.

The following table is a summary of FHLB borrowings for fiscal years 2010 and 2009:

Dollars in Thousands		**2010**		**2009**
Balance at year-end	$	8,000	$	32,200
Average balance during the year	$	19,161	$	44,038
Maximum amount outstanding at any month-end	$	24,200	$	79,000
Average interest rate during the year		1.71%		1.55%
Average interest rate at year-end		1.10%		1.75%

Return on Equity and Assets

The following table sets forth certain information regarding our return on equity and assets for the periods indicated:

	At December 31, 2010	**At December 31, 2009**
Return on average assets	0.88%	0.38%
Return on average common equity	7.65%	2.51%
Dividend payout ratio	0.00%	16.54%
Equity to assets ratio	11.69%	11.57%

Deferred Compensation Obligations

We maintain a nonqualified, unfunded deferred compensation plan for certain key management personnel. Under this plan, participating employees may defer compensation, which will entitle them to receive certain payments upon retirement, death, or disability. The plan provides for payments commencing upon retirement and reduced benefits upon early retirement, disability, or termination of employment. At December 31, 2010 and 2009, our aggregate payment obligations under this plan totaled $7.5 million and $7.6 million, respectively.

Off-Balance Sheet Arrangements

During the ordinary course of business, we provide various forms of credit lines to meet the financing needs of our customers. These commitments, which represent a credit risk to us, are not represented in any form on our balance sheets.

As of December 31, 2010, and 2009, we had commitments to extend credit of $59.9 million and $63.1 million, respectively. Obligations under standby letters of credit were $1.4 million and $2.8 million, for 2010, and 2009, respectively, and there were no obligations under commercial letters of credit for either period.

The effect on our revenues, expenses, cash flows and liquidity from the unused portion of the commitments to provide credit cannot be reasonably predicted because there is no guarantee that the lines of credit will be used. For more information regarding our off balance sheet arrangements, see Note 14- Commitments and Other Contingencies- to our 2010 year-end financial statements located elsewhere in this report.

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Contractual Obligations

The following chart summarizes certain contractual obligations of the Bank as of December 31, 2010 (dollars in thousands):

Contractual Obligations	Less than 1 Year	1-3 years	3-5 years	More than 5 years	Total
FHLB borrowings	$ 5,000	$ 3,000	$ 0	$ 0	$ 8,000
Operating lease obligations	857	1,761	1,513	2,482	6,613
Supplemental retirement plans	12	130	28	1,130	1,300
Time deposit maturities	53,793	16,290	3,121	0	73,204
Total	$ 59,662	$ 21,181	$ 4,662	$ 3,612	$ 89,117

As permitted or required under California law and to the maximum extent allowable under that law, we have certain obligations to indemnify our current and former officers and directors for certain events or occurrences while the officer or director is, or was serving, at our request in such capacity. We also have the power to similarly indemnify our current and former officers. These indemnification obligations are valid as long as the director or officer acted in good faith and in a manner the person reasonably believed to be in, or not opposed to, our best interests, and with respect to any criminal action or proceeding, had no reasonable cause to believe his or her conduct was unlawful. The maximum potential amount of future payments we could be required to make under these indemnification obligations is unlimited; however, we have a director and officer insurance policy that mitigates our exposure and enables us to recover a portion of any future amounts paid. We believe the estimated fair value of these indemnification obligations is minimal.

Liquidity and Asset/Liability Management

Management seeks to ascertain optimum and stable utilization of available assets and liabilities as a vehicle to attain our overall business plans and objectives. In this regard, management focuses on measurement and control of liquidity risk, interest rate risk and market risk, capital adequacy, operation risk and credit risk.

Liquidity

Liquidity to meet borrowers credit and depositors withdrawal demands is provided by maturing assets, short-term liquid assets that can be converted to cash and the ability to attract funds from depositors. Additional sources of liquidity may include institutional deposits, advances from the FHLB and other short-term borrowings, such as federal funds purchased.

Since our deposit growth strategy emphasizes core deposit growth we have avoided relying on brokered deposits as a consistent source of funds. The only brokered deposit the Bank holds are from CDARS, a certificate of deposit program that exchanges funds with other network banks to offer full FDIC insurance coverage to the customer. The Bank had $3.8 million and $11.4 million in brokered deposits as of December 31, 2010 and 2009, respectively.

As a secondary source of liquidity, we rely on advances from the FHLB to supplement our supply of lendable funds and to meet deposit withdrawal requirements. Advances from the FHLB are typically secured by a portion of our loan portfolio and stock issued by the FHLB. The FHLB determines limitations on the amount of advances by assigning a percentage to each eligible loan category that will count towards the borrowing capacity. At December 31, 2010 and December 31, 2009, the Bank had total FHLB advances outstanding of $8.0 million and $32.2 million which equaled 7% and 27% of our borrowing capacity, respectively. At December 31, 2010 and December 31, 2009, the Bank had sufficient collateral to borrow an additional $113.9 million and $86.2 million, respectively. In addition, the Bank had lines of credit with its correspondent banks to purchase overnight federal funds totaling $15 million and $20 million at December 31, 2010 and 2009, respectively. No advances were made on these lines of credit as of December 31, 2010 and December 31, 2009.

Oak Valley Bancorp s liquidity depends primarily on dividends paid to it as sole shareholder of the Bank. The Bank s ability to pay dividends to Oak Valley Bancorp without regulatory approval will depend on whether the Bank will be in a position to pay dividends.

Maintenance of adequate liquidity requires that sufficient resources be available at all time to meet our cash flow requirements. Liquidity in a banking institution is required primarily to provide for deposit withdrawals and the credit needs of its

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customers and to take advantage of investment opportunities as they arise. Liquidity management involves our ability to convert assets into cash or cash equivalents without incurring significant loss, and to raise cash or maintain funds without incurring excessive additional cost. For this purpose, we maintain a portion of our funds in cash and cash equivalents, loans and securities available for sale. Our liquid assets at December 31, 2010 and 2009 totaled approximately $129.0 million and $80.1 million, respectively. Our liquidity level measured as the percentage of liquid assets to total assets was 23.33% and 15.26% at December 31, 2010, and 2009, respectively.

Capital Resources and Capital Adequacy Requirements

In the past two years, our primary source of capital has been internally generated operating income through retained earnings. At December 31, 2010, total shareholders equity increased to $64.7 million, representing an increase of $4.0 million from December 31, 2009. In December 2008, the Bank was selected to participate in the U.S. Treasury Capital Purchase Program which demonstrates the confidence the U.S. Treasury Department has in the stability of the Bank. The Bank issued $13.5 million in preferred stock and intends to use the capital to increase credit availability to local, creditworthy, businesses and consumers. The preferred stock shares have a 5% coupon for 5 years and 9% thereafter. Warrants to purchase 350,346 shares of common stock at a per share exercise price of $5.78 are attached and fully exercisable. The warrants expire 10 years after the issuance date. The securities issued to the Treasury are accounted for as components of regulatory Tier 1 capital.

As of December 31, 2010, we had no material commitments for capital expenditures other than the preferred stock dividend payments due to the U.S. Treasury Department.

We are subject to various regulatory capital requirements administered by federal banking agencies. Failure to meet minimum capital requirements can trigger regulatory actions that could have a material adverse effect on our financial statements and operations. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, we must meet specific capital guidelines that rely on quantitative measures of our assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. Our capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. (See Description of Business-Regulation and Supervision-Capital Adequacy Requirements herein for exact definitions and regulatory capital requirements.)

As of December 31, 2010, we were qualified as a well capitalized institution under the regulatory framework for prompt corrective action. The following table presents the regulatory standards for well-capitalized institutions, compared to the Bank s capital ratios as of the dates specified:

	Regulatory Well-Capitalized Standards	December 31, 2010	December 31, 2009
Total capital to risk-weighted assets	10.0%	14.9%	13.6%
Tier I capital to risk-weighted assets	6.0%	13.7%	12.3%
Tier I capital to average assets	5.0%	11.5%	11.3%

Market Risk

Market risk is the risk of loss of future earnings, fair values, or future cash flows that may result from changes in the price of a financial instrument. The value of a financial instrument may change as a result of changes in interest rates, foreign currency exchange rates, commodity prices, equity prices and other market changes that affect market risk sensitive instruments. Market risk is attributed to all market risk sensitive financial instruments, including securities, loans, deposits and borrowings, as well as the Bank s role as a financial intermediary in customer-related transactions. The objective of market risk management is to avoid excessive exposure of the Bank s earnings and equity to loss and to reduce the volatility inherent in certain financial instruments.

Interest Rate Management

Market risk arises from changes in interest rates, exchange rates, commodity prices and equity prices. The Bank s market risk exposure is primarily that of interest rate risk, and it has established policies and procedures to monitor and limit earnings and balance sheet exposure to changes in interest rates. The Bank does not engage in the trading of financial instruments, nor does the Bank have exposure to currency exchange rates.

The principal objective of interest rate risk management (often referred to as asset/liability management) is to manage the financial components of the Bank in a manner that will optimize the risk/reward equation for earnings and capital in relation to changing interest rates. The Bank s exposure to market risk is reviewed on a regular basis by the Asset/Liability Committee. Interest rate risk is the potential of economic losses due to future interest rate changes. These economic losses can be reflected as a loss of future net interest income and/or a loss of current fair market values. The objective is to measure the effect on net interest income and to adjust the balance sheet to minimize the inherent risk while at the same time maximizing income. Management realizes certain risks are inherent, and that the goal is to identify and manage the risks. Management uses two methodologies to manage interest rate risk: (i) a standard GAP analysis; and (ii) an interest rate shock simulation model.

The planning of asset and liability maturities is an integral part of the management of an institution s net interest margin. To the extent maturities of assets and liabilities do not match in a changing interest rate environment, the net interest margin may change over time. Even with perfectly matched repricing of assets and liabilities, risks remain in the form of prepayment of loans or securities or in the form of delays in the adjustment of rates of interest applying to either earning assets with floating rates or to interest bearing liabilities. The Bank has generally been able to control its exposure to changing interest rates by maintaining primarily floating interest rate loans and a majority of its time certificates with relatively short maturities.

Interest rate changes do not affect all categories of assets and liabilities equally or at the same time. Varying interest rate environments can create unexpected changes in prepayment levels of assets and liabilities, which may have a significant effect on the net interest margin and are not reflected in the interest sensitivity analysis table. Because of these factors, an interest sensitivity gap report may not provide a complete assessment of the exposure to changes in interest rates.

The Bank uses modeling software for asset/liability management in order to simulate the effects of potential interest rate changes on the Bank s net interest margin, and to calculate the estimated fair values of the Bank s financial instruments under different interest rate scenarios. The program imports current balances, interest rates, maturity dates and repricing information for individual financial instruments, and incorporates assumptions on the characteristics of embedded options along with pricing and duration for new volumes to project the effects of a given interest rate change on the Bank s interest income and interest expense. Rate scenarios consisting of key rate and yield curve projections are run against the Bank s investment, loan, deposit and borrowed funds portfolios. These rate projections can be shocked (an immediate and parallel change in all base rates, up or down) and ramped (an incremental increase or decrease in rates over a specified time period), based on current trends and econometric models or stable economic conditions (unchanged from current actual levels).

The Bank applies a market value (MV) methodology to gauge its interest rate risk exposure as derived from its simulation model. Generally, MV is the discounted present value of the difference between incoming cash flows on interest-earning assets and other investments and outgoing cash flows on interest-bearing liabilities and other liabilities. The application of the methodology attempts to quantify interest rate risk as the change in the MV which would result from a theoretical 200 basis point (1 basis point equals 0.01%) change in market interest rates. Both a 200 basis point increase and a 200 basis point decrease in market rates are considered.

At December 31, 2010, it was estimated that the Bank s MV would decrease 12.75% in the event of an immediate 200 basis point increase in market interest rates. The Bank s MV at the same date would increase 11.78% in the event of an immediate 200 basis point decrease in applicable interest rates.

Presented below, as of December 31, 2010 and 2009, is an analysis of the Bank s interest rate risk as measured by changes in MV for instantaneous and sustained parallel shifts of applicable interest rates:

	2010				2009			
			Market Value as a % of Present Value of Assets				Market Value as a % of Present Value of Assets	
Shock Scenario	$ Change in Market Value	% Change in Market Value	MV Ratio	Change (bp)	$ Change in Market Value	% Change in Market Value	MV Ratio	Change (bp)
				(Dollars in Thousands)				
+200 bp	$ (9,372)	(12.75)%	11.98%	(1)	$ (13,223)	(17.75)%	11.99%	$ (197)
+100 bp	$ (4,182)	(5.69)%	12.69%	(0)	$ (7,393)	(9.92)%	12.87%	$ (109)
0 bp	$	0.00%	13.17%		$	0.00%	13.96%	$
-100 bp	$ 6,744	9.17%	14.02%	1	$ 6,679	8.97%	14.88%	$ 92
-200 bp	$ 8,658	11.78%	14.15%	1	$ 3,334	4.48%	14.16%	$ 20

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Management believes that the MV methodology overcomes three shortcomings of the typical maturity gap methodology. First, it does not use arbitrary repricing intervals and accounts for all expected future cash flows. Second, because the MV method projects cash flows of each financial instrument under different interest rate environments, it can incorporate the effect of embedded options on an institution s interest rate risk exposure. Third, it allows interest rates on different instruments to change by varying amounts in response to a change in market interest rates, resulting in more accurate estimates of cash flows.

However, as with any method of gauging interest rate risk, there are certain shortcomings inherent to the MV methodology. The model assumes interest rate changes are instantaneous parallel shifts in the yield curve. In reality, rate changes are rarely instantaneous. The use of the simplifying assumption that short-term and long-term rates change by the same degree may also misstate historic rate patterns, which rarely show parallel yield curve shifts. Further, the model assumes that certain assets and liabilities of similar maturity or period to repricing will react in the same way to changes in rates. In reality, certain types of financial instruments may react in advance of changes in market rates, while the reaction of other types of financial instruments may lag behind the change in general market rates. When interest rates change, actual loan prepayments and actual early withdrawals from certificates may deviate significantly from the assumptions used in the model. Finally, this methodology does not measure or reflect the impact that higher rates may have on adjustable-rate loan clients ability to service their debt. All of these factors are considered in monitoring the Bank s exposure to interest rate risk.

Impact of Inflation; Seasonality

Inflation primarily impacts us by its effect on interest rates. Our primary source of income is net interest income, which is affected by changes in interest rates. We attempt to limit the impact of inflation on our net interest margin through management of rate-sensitive assets and liabilities and the analysis of interest rate sensitivity. The effect of inflation on premises and equipment as well as noninterest expenses has not been significant for the periods covered in this report. Our business is generally not seasonal.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Not required.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Our consolidated financial statements and the Independent Auditors Report appear on pages F-1 through F-40 of this Report and are incorporated into this Item 8 by reference.

INDEX TO FINANCIAL STATEMENTS

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

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ITEM 9A. CONTROLS AND PROCEDURES

Disclosure Control and Procedures

The Company s management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company s disclosure controls and procedures as of December 31, 2010. As defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act), disclosure controls and procedures are controls and procedures designed to reasonably assure that information required to be disclosed in our reports filed or submitted under the Exchange Act are recorded, processed, summarized and reported on a timely basis. Disclosure controls are also designed to reasonably assure that such information is accumulated and communicated to our management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. Based upon their evaluation, our Chief Executive Officer and Chief Financial Officer concluded that the Company s disclosure controls were effective as of December 31, 2010, the period covered by this report.

Inherent Limitations on Effectiveness of Controls

The Company s management, including the Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls or our internal control over financial reporting will prevent or detect all errors and fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system s objectives will be met. The design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Further, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Projections of any evaluation of controls effectiveness to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures.

Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting that occurred during the quarter ended December 31, 2010 that has materially affected or is reasonably likely to materially affect our internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None.

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PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this Item is incorporated by reference from our Proxy Statement to be filed prior to the 2011 Annual Meeting of Shareholders. The Company and the Bank have adopted a Code of Ethics that applies to all staff including the Chief Executive Officer, and the Chief Financial Officer. A copy of the Code of Ethics will be provided to any person, without charge, upon written request to Corporate Secretary, Oak Valley Bancorp, 125 North Third Avenue, Oakdale, CA 95361.

ITEM 11. EXECUTIVE COMPENSATION

The information required by this Item is incorporated by reference from our Proxy Statement to be filed prior to the 2010 Annual Meeting of Shareholders.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by this Item is incorporated by reference from our Proxy Statement to be filed prior to the 2011 Annual Meeting of Shareholders.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by this Item is incorporated by reference from our Proxy Statement to be filed prior to the 2011 Annual Meeting of Shareholders.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by this Item is incorporated by reference from our Proxy Statement to be filed prior to the 2011 Annual Meeting of Shareholders.

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PART IV

ITEM 15 EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a)(1) Financial Statements

The Financial Statements of the Company and the Report of Independent Registered Public Accounting Firm are set forth on pages F-1 through F-31.

(a)(2) Financial Statement Schedules

All schedules to the Financial Statements are omitted because of the absence of the conditions under which they are required or because the required information is included in the Financial Statements or accompanying notes.

(a)(3) Exhibits

The exhibit list required by this Item is incorporated by reference to the Exhibit Index included in this report. The warranties, representations and covenants contained in any of the agreements included herein or which appear as exhibits hereto should not be relied upon by buyers, sellers or holders of the Company s securities and are not intended as warranties, representations or covenants to any individual or entity except as specifically set forth in such agreement

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in Oakdale, California on March 25, 2011.

OAK VALLEY BANCORP
a California corporation

By:	/s/ RONALD C. MARTIN Ronald C. Martin, *Chief Executive Officer*

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the date indicated.

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that each of the undersigned officers and directors of the registrant hereby constitutes and appoints Ronald C. Martin and Richard A. McCarty, and each of them, as lawful attorney-in-fact and agent for each of the undersigned (with full power of substitution and resubstitution, for and in the name, place and stead of each of the undersigned officers and directors), to sign and file with the Securities and Exchange Commission under the Securities Exchange Act of 1934, as amended, any and all amendments, supplements and exhibits to this report and any and all other documents in connection therewith, hereby granting unto said attorneys-in-fact, and each of them, full power and authority to do and perform each and every act and thing necessary or desirable to be done in order to effectuate the same as fully and to all intents and purposes as each of the undersigned might or could do if personally present, hereby ratifying and confirming all that said attorneys-in-fact and agents, or any of them, or any of their substitutes, may do or cause to be done by virtue hereof.

Signature	Title	Date
/s/ DONALD BARTON Donald Barton	Director	March 25, 2011
/s/ CHRISTOPHER M. COURTNEY Christopher M. Courtney	Director	March 25, 2011
/s/ JAMES L. GILBERT James L. Gilbert	Director	March 25, 2011
/s/ THOMAS A. HAIDLEN Thomas A. Haidlen	Director	March 25, 2011

/s/ MICHAEL Q. JONES Michael Q. Jones	Director	March 25, 2011
/s/ RONALD C. MARTIN Ronald C. Martin	Director	March 25, 2011
/s/ ROGER M. SCHRIMP Roger M. Schrimp	Director	March 25, 2011
/s/ DANNY L. TITUS Danny L. Titus	Director	March 25, 2011
/s/ RICHARD J. VAUGHAN Richard J. Vaughan	Director	March 25, 2011

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MANAGEMENT S ASSESSMENT OF INTERNAL CONTROL OVER FINANCIAL REPORTING

The management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. The Company s internal control over financial reporting is a process designed under the supervision of the Company s Chief Executive Officer and Chief Financial Officer to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company s financial statements for external purposes in accordance with U.S. generally accepted accounting principles.

As of December 31, 2010, management assessed the effectiveness of the Company s internal control over financial reporting based on the criteria for effective internal control over financial reporting established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and guidance issued by the Securities and Exchange Commission. Based on the assessment, management determined that the Company maintained effective internal control over financial reporting as of December 31, 2010, based on those criteria.

The Company s management, including its Chief Executive Officer and Chief Financial Officer, does not expect that its disclosure controls and procedures, or its internal controls will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints and the benefit of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected.

/s/ RONALD C. MARTIN
Ronald C. Martin, *Chief Executive Officer*

/s/ RICHARD A. MCCARTY
Richard A. McCarty, *Chief Financial Officer*

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders

Oak Valley Bancorp

We have audited the accompanying consolidated balance sheets of Oak Valley Bancorp and subsidiary (the Company) as of December 31, 2010 and 2009 and the related consolidated statements of earnings, shareholders equity, and cash flows for the years ended December 31, 2010 and 2009. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company s internal control over financial reporting. Accordingly, we express no such opinion. 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 consolidated financial position of Oak Valley Bancorp and subsidiary as of December 31, 2010 and 2009, and the consolidated results of their operations and their cash flows for the years ended December 31, 2010 and 2009 in conformity with accounting principles generally accepted in the United States of America.

/s/ Moss Adams LLP

Stockton, California

March 28, 2011

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OAK VALLEY BANCORP

BALANCE SHEETS

	December 31, 2010	December 31, 2009
ASSETS		
Cash and due from banks	$ 28,091,916	$ 20,003,548
Federal funds sold	40,845,000	1,645,000
Cash and cash equivalents	68,936,916	21,648,548
Securities available for sale	53,267,982	50,765,314
Loans, net of allowance for loan loss of $8,254,929 in 2010 and $7,020,222 in 2009	395,206,208	417,795,686
Bank premises and equipment, net	10,173,822	10,167,297
Other real estate owned (OREO)	778,174	2,149,514
Accrued interest and other assets	24,033,316	22,195,354
	$ 552,396,418	$ 524,721,713
LIABILITIES AND SHAREHOLDERS EQUITY		
Deposits	$ 476,738,850	$ 429,210,284
Accrued interest and other liabilities	2,999,836	2,619,178
FHLB advances	8,000,000	32,200,000
Total liabilities	487,738,686	464,029,462
Commitments and contingencies (Note 14)		
Shareholders equity		
Preferred stock, no par value; $1,000 per share liquidation preference, 10,000,000 shares authorized and 13,500 issued and outstanding at December 31, 2010 and December 31, 2009	13,013,945	12,847,297
Common stock, no par value; 50,000,000 shares authorized, 7,702,127 and 7,681,877 shares issued and outstanding at December 31, 2010 and 2009, respectively	24,003,549	23,933,440
Additional paid-in capital	2,080,218	1,997,747
Retained earnings	24,016,466	20,230,683
Accumulated other comprehensive income, net of tax	1,543,554	1,683,084
Total shareholders equity	64,657,732	60,692,251
	$ 552,396,418	$ 524,721,713

See accompanying notes

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OAK VALLEY BANCORP

STATEMENTS OF EARNINGS

	YEAR ENDED DECEMBER 31, 2010	2009
INTEREST INCOME		
Interest and fees on loans	$ 25,503,634	$ 26,686,633
Interest on securities available for sale	2,361,723	2,585,816
Interest on federal funds sold	19,133	5,117
Interest on deposits with banks	41,595	5,205
Total interest income	27,926,085	29,282,771
INTEREST EXPENSE		
Deposits	2,591,086	4,956,231
FHLB advances	327,900	684,137
Federal funds purchased	110	419
Total interest expense	2,919,096	5,640,787
Net interest income	25,006,989	23,641,984
PROVISION FOR LOAN LOSSES	4,020,000	5,862,012
Net interest income after provision for loan losses	20,986,989	17,779,972
OTHER INCOME		
Service charges on deposits	1,065,063	1,163,515
Earnings on cash surrender value of life insurance	435,884	408,628
Mortgage commissions	107,848	139,757
Other	1,160,736	929,483
Total non-interest income	2,769,531	2,641,383
OTHER EXPENSES		
Salaries and employee benefits	8,456,982	7,780,574
Occupancy expenses	2,699,897	2,717,285
Data processing fees	947,338	894,056
OREO expenses	637,725	2,653,205
Regulatory assessments (FDIC & DFI)	1,051,262	996,288
Other operating expenses	2,982,626	3,177,025
Total non-interest expense	16,775,830	18,218,433
Net income before provision for income taxes	6,980,690	2,202,922
PROVISION FOR INCOME TAXES	2,353,259	203,194
NET INCOME	$ 4,627,431	$ 1,999,728
Preferred stock dividends and accretion	841,648	841,644
NET INCOME AVAILABLE TO COMMON SHAREHOLDERS	$ 3,785,783	$ 1,158,084
NET INCOME PER COMMON SHARE	$ 0.49	$ 0.15
NET INCOME PER DILUTED COMMON SHARE	$ 0.49	$ 0.15

See accompanying notes

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OAK VALLEY BANCORP

STATEMENTS OF SHAREHOLDERS EQUITY

YEARS ENDED DECEMBER 31, 2010 AND 2009

	Common Stock		Preferred Stock		Additional Paid-in	Retained	Comprehensive	Accumulated Other Comprehensive	Total Shareholders
	Shares	Amount	Shares	Amount	Capital	Earnings	Income	Income	Equity
Balances, January 1, 2009	7,661,627	$ 23,863,331	13,500	$ 12,680,649	$ 1,925,224	$ 19,226,645		$ 290,230	$ 57,986,079
Stock options exercised	20,250	$ 70,109							70,109
Preferred stock accretion				$ 166,648		$ (166,648)			0
Preferred stock dividend payments						(637,500)			(637,500)
Cash dividends ($0.025 per share)						(191,542)			(191,542)
Stock based compensation					72,523				72,523
Comprehensive income:									
Net changes in unrealized gain on available-for-sale securities (net of income tax of $988,188)									