

FIRST NORTHERN COMMUNITY BANCORP
Form 10-K
March 14, 2008

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

FORM 10-K

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

For the Fiscal Year Ended December 31, 2007

OR

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

For the transition period from _____ to _____. Commission File Number 000-30707
First Northern Community Bancorp
(Exact name of Registrant as specified in its charter)

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

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

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

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

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

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 No

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 No

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

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

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

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

Yes No

The aggregate market value of the Common Stock held by non-affiliates of the registrant on June 30, 2007 (based upon the last reported sales price of such stock on the OTC Bulletin Board on June 30, 2007) was \$146,582,485.

The number of shares of Common Stock outstanding as of March 12, 2008 was 8,136,075.

DOCUMENTS INCORPORATED BY REFERENCE

Items 10, 11, 12 (as to security ownership of certain beneficial owners and management), 13 and 14 of Part III incorporate by reference information from the registrant’s proxy statement to be filed with the Securities and Exchange Commission in connection with the solicitation of proxies for the registrant’s 2008 Annual Meeting of Shareholders.

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

PART I

ITEM 1 - BUSINESS

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

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

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

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

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

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

The Bank has eleven full service branches. Four are located in the Solano County cities of Dixon, Fairfield, and Vacaville (2). Four branches are located in the Yolo County cities of Winters, Davis, West Sacramento and Woodland. Two branches are located in Sacramento County, one in Downtown Sacramento and the other in the city

of Folsom, and one branch is located in the city of Roseville in Placer County. The Bank also has two satellite banking offices inside retirement communities in the city of Davis. In addition, the Bank has real estate loan offices in Davis, Woodland, Folsom and Roseville that originate residential mortgages and construction loans. The Bank also has a Small Business Administration (“SBA”) Loan Department and an Asset Management & Trust Department in Downtown Sacramento that serve the Bank’s entire market area.

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

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

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

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

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

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

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

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

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

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

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

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

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

The Bank's eighth branch, the Downtown Financial Center, opened in July of 2000 in Vacaville to serve the business and individual financial needs on the west side of Interstate-80. Also in July of 2000, in an adjacent office, the Bank opened its third real estate loan production office. The Vacaville real estate loan office was closed in 2007 in response to the current dramatic slowdown in the housing market.

Two satellite banking offices of the Bank's Davis Branch were opened in 2001 in the Davis senior living communities of Covell Gardens and the University Retirement Community.

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

In March of 2002, the Bank opened its ninth branch in a new class-A commercial building located on the harbor in Suisun City. Suisun's Downtown waterfront area is part of an ongoing community revitalization project put into place with the goal of attracting new small businesses and merchants. After five years in operation and slower than anticipated city growth, in 2007 the Bank decided to close its Suisun City Branch and serve the Branch's customers out of its Fairfield Branch. The Fairfield Branch was expanded and remodeled to accommodate the additional customers and to include an investment & brokerage services office.

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

In August of 2003, a full service real estate loan production office was opened in Woodland. This loan office is located within the same commercial office complex as the Bank's Woodland Branch. The Bank's history of servicing the Woodland community, coupled with the continued growth of the Woodland housing market, prompted this decision to expand the Bank's real estate loan services for the community.

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

In the fourth quarter of 2006, the Bank opened its Folsom Financial Center which houses a full service branch, a real estate loan production office, and an investment & brokerage services office. Folsom is one of the fastest growing cities in Sacramento County and its central proximity to Rancho Cordova and El Dorado Hills makes it ideal for building market share in the eastern part of the County.

At the end of 2007, the Bank announced its intention to open a full service branch in the city of Auburn, the county seat of Placer County. The Auburn Branch is expected to open in mid-2008.

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

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

As of December 31, 2007, the Company and the Bank employed 243 full-time equivalent staff. The Company and the Bank consider their relationship with their employees to be good and have not experienced any interruptions of operations due to labor disagreements.

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

Available Information

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

The Effect of Government Policy on Banking

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

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

Regulation and Supervision of Bank Holding Companies

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

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

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

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

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

the proposed activity will outweigh the possible adverse effects associated with such activity.

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

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

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

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

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

may not sell a low-quality asset to the Bank.

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Bank Regulation and Supervision

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

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

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

The USA Patriot Act

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

Part of the USA Patriot Act is the International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001 (“IMLAFATA”). Among its provisions, IMLAFATA requires each financial institution to: (i) establish an anti-money laundering program; (ii) establish appropriate anti-money laundering policies, procedures and controls; (iii) appoint a Bank Secrecy Act officer responsible for day-to-day compliance; and (iv) conduct independent audits. In addition, IMLAFATA contains a provision encouraging cooperation among financial institutions,

regulatory authorities and law enforcement authorities with respect to individuals, entities and organizations engaged in, or reasonably suspected of engaging in, terrorist acts or money laundering activities. IMLAFATA expands the circumstances under which funds in a bank account may be forfeited and requires covered financial institutions to respond under certain circumstances to requests for information from federal banking agencies within 120 hours. IMLAFATA also amends the BHCA and the Bank Merger Act to require the federal banking agencies to consider the effectiveness of a financial institution's anti-money laundering activities when reviewing an application under these Acts.

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

Privacy Restrictions

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

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

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

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

Capital Standards

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

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

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

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

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

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

As of December 31, 2007, the Company's and the Bank's capital ratios exceeded applicable regulatory requirements.

The following tables present the capital ratios for the Company and the Bank, compared to the standards for well-capitalized bank holding companies and depository institutions, as of December 31, 2007 (amounts in thousands except percentage amounts).

	The Company			
	Actual Capital	Ratio	Well Capitalized Ratio	Minimum Capital Requirement
Leverage	\$ 64,046	9.1%	5.0%	4.0%
Tier 1 Risk-Based	64,046	10.7%	6.0%	4.0%
Total Risk-Based	71,336	11.9%	10.0%	8.0%

	The Bank			
	Actual Capital	Ratio	Well Capitalized Ratio	Minimum Capital Requirement
Leverage	\$ 63,065	9.0%	5.0%	4.0%
Tier 1 Risk-Based	63,065	10.6%	6.0%	4.0%
Total Risk-Based	70,355	11.8%	10.0%	8.0%

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

Prompt Corrective Action and Other Enforcement Mechanisms

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

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

"Well capitalized"

Total risk-based capital of 10%;
Tier 1 risk-based capital of 6%; and
Leverage ratio of 5%.

"Adequately capitalized"

Total risk-based capital of 8%;
Tier 1 risk-based capital of 4%; and
Leverage ratio of 4%.

“Undercapitalized”

Total risk-based capital less than 8%;

Tier 1 risk-based capital less than 4%; or

Leverage ratio less than 4%.

“Significantly undercapitalized”

Total risk-based capital less than 6%;

Tier 1 risk-based capital less than 3%; or

Leverage ratio less than 3%.

“Critically undercapitalized”

Tangible equity to total assets less than

2%.

An institution that, based upon its capital levels, is classified as “well capitalized,” “adequately capitalized” or “undercapitalized” may be treated as though it were in the next lower capital category if the appropriate federal banking agency, after notice and opportunity for hearing, determines that an unsafe or unsound condition or an unsafe or unsound practice warrants such treatment. At each successive lower capital category, an insured depository institution is subject to more restrictions. Management believes that at December 31, 2007, the Company and the Bank met the requirements for “well capitalized” institutions.

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

Safety and Soundness Standards

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

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

Restrictions on Dividends and Other Distributions

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

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

In addition to the restrictions imposed under federal law, banks chartered under California law generally may only pay cash dividends to the extent such payments do not exceed the lesser of retained earnings of the bank’s net income for its last three fiscal years (less any distributions to shareholders during such period). In the event a bank desires to pay

cash dividends in excess of such amount, the bank may pay a cash dividend with the prior approval of the Commissioner in an amount not exceeding the greatest of the bank's retained earnings, the bank's net income for its last fiscal year, or the bank's net income for its current fiscal year.

Premiums for Deposit Insurance

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

The Federal Deposit Insurance Reform Act of 2005, as implemented by the FDIC, adopted a new schedule of rates that the FDIC can adjust up or down, depending on the revenue needs of the insurance fund. To offset assessments, a member institution may apply certain one time credits, based on the institution’s (or its successor’s) assessment base as of the end of 1996. An institution may apply available credits up to 100% of assessments in 2007, and up to 90% of assessments in each of 2008, 2009 and 2010. Although an FDIC credit for prior contributions offset most of the assessment for 2007, the insurance assessments the Bank will pay has increased our costs starting in 2008. This new assessment system has resulted in annual assessments on deposits of the Bank of approximately \$419,000. Any further increases in the deposit insurance assessments the Bank pays would further increase our costs.

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

The Deposit Insurance Funds Act of 1996 (the “Deposit Funds Act”) separated the Financing Corporation (“FICO”) assessment to service the interest on FICO bond obligations from the BIF and SAIF assessments. The FICO annual assessment on individual depository institutions is in addition to the amount, if any, paid for deposit insurance according to the FDIC’s risk-based assessment rate schedules. FICO assessment rates may be adjusted quarterly by the FDIC. The current FICO assessment rate is 1.32 cents per \$100 of deposits. In addition, the FDIC has authority to impose special assessments from time to time, subject to certain limitations specified in the Deposit Funds Act.

Community Reinvestment Act and Fair Lending

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

Sarbanes – Oxley Act

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

- the creation of a five-member oversight board that sets standards for accountants and has investigative and disciplinary powers;
 - the prohibition of accounting firms from providing various types of consulting services to public clients and requires accounting firms to rotate partners among public client assignments every five years;

- increased penalties for financial crimes;
- expanded disclosure of corporate operations and internal controls and certification of financial statements;
- enhanced controls on, and reporting of, insider trading; and
- prohibition on lending to officers and directors of public companies, although the Bank may continue to make these loans within the constraints of existing banking regulations.

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

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

Pending Legislation and Regulations

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

Competition

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

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

In order to compete with major financial institutions and other competitors in its primary service areas, the Bank relies upon the experience of its executive and senior officers in serving business clients, and upon its specialized services, local promotional activities and the personal contacts made by its officers, directors and employees.

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

ITEM 1A – RISK FACTORS

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

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

Commencing in 2007 and continuing into 2008, certain adverse financial developments have impacted the U.S. economy and financial markets and present challenges for the banking and financial services industry and for the Bank. These developments include a general slowing of economic growth in the U.S. which has prompted the Congress to adopt an economic stimulus bill which President Bush signed into law on February 13, 2008, and which prompted the Federal Reserve Board to decrease its discount rate and the federal funds rate several times in the first quarter of 2008. These developments have contributed to substantial volatility in the equity securities markets, as well as volatility and a tightening of liquidity in the credit markets. In addition, financial and credit conditions in the domestic residential real estate markets have deteriorated significantly, particularly in the subprime sector. These conditions in turn have led to significant deterioration in certain financial markets, particularly the markets for subprime residential mortgage-backed securities and for collateralized debt obligations backed by residential mortgage-backed securities. If, notwithstanding the federal government's recent fiscal and monetary measures, the U.S. economy were to go into a recession, this would present additional significant challenges for the U.S. banking and financial services industry and for the Bank. While it is difficult to predict how long these conditions will exist and how and the extent to which the Bank may be affected, these factors could continue to present risks for some time for the industry and the Bank's financial condition, results of operations, cash flows and business prospects.

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

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

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

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

At December 31, 2007, approximately 69% of the Bank's loans (excluding loans held-for-sale) were secured by real estate. The value of the Bank's real estate collateral has been, and could in the future continue to be, adversely affected by any economic recession and any resulting adverse impact on the real estate market in Northern California such as that experienced during the early 1990's. See "The U.S. Economy Has Experienced a Slowing of Economic Growth, Volatility in the Financial Markets and Significant Deterioration in Sectors of the U.S. Residential Real Estate Markets, All of Which Present Challenges for the Banking and Financial Services Industry and for the Bank" above, and "Adverse California Economic Conditions Could Adversely Affect the Bank's Business" below.

The Bank's primary lending focus has historically been commercial (including agricultural), construction and real estate mortgage. At December 31, 2007, real estate mortgage (excluding loans held-for-sale) and construction loans comprised approximately 51% and 18%, respectively, of the total loans in the Bank's portfolio. At December 31, 2007, all of the Bank's real estate mortgage and construction loans and approximately 6% of its commercial loans were secured fully or in part by deeds of trust on underlying real estate. The Company's dependence on real estate increases the risk of loss in both the Bank's loan portfolio and its holdings of other real estate owned if economic conditions in Northern California further deteriorate in the future. Further deterioration of the real estate market in Northern California would have a material adverse effect on the Company's business, financial condition and results of operations. See "Adverse California Economic Conditions Could Adversely Affect the Bank's Business" below.

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

The Bank's operations and a substantial majority of the Bank's assets and deposits are generated and concentrated primarily in Northern California, particularly the counties of Placer, Sacramento, Solano and Yolo, and are likely to remain so for the foreseeable future. At December 31, 2007, approximately 69% of the Bank's loan portfolio (excluding loans held-for-sale) consisted of real estate-related loans, all of which were secured by collateral located in Northern California. As a result, a further downturn in the economic conditions in Northern California may cause the Bank to incur losses associated with high default rates and decreased collateral values in its loan portfolio. In the early 1990's, the California economy experienced an economic recession that resulted in increases in the level of delinquencies and losses for many of the state's financial institutions. Economic conditions in California are subject to various uncertainties at this time, including the significant deterioration in the California real estate market and housing industry. California's state government is currently experiencing budget shortfalls which in January 2008 prompted Governor Schwarzenegger to declare a fiscal emergency. This declaration could lead to reduced spending by the State of California and its agencies. It is also possible that the legislative response to the budget crisis could lead to increased state taxes in California. The financial and economic consequences of this situation cannot be predicted with any certainty at this time. If economic conditions in California decline further or if California were to experience another recession, it is expected that the Bank's level of problem assets would increase. California real estate is also subject to certain natural disasters, such as earthquakes, floods and mudslides, which are typically not covered by the standard hazard insurance policies maintained by borrowers. Uninsured disasters may make it difficult or impossible for borrowers to repay loans made by the Bank. The occurrence of natural disasters in California could have a material adverse effect on the Company's financial condition, results of operations, cash flows and business prospects.

The Bank is Subject to Interest Rate Risk

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

Potential Volatility of Deposits May Increase Our Cost of Funds

At December 31, 2007, 11% of the dollar value of the Company's total deposits was represented by time certificates of deposit in excess of \$100,000. These deposits are considered volatile and could be subject to withdrawal. Withdrawal of a material amount of such deposits would adversely impact the Company's liquidity, profitability, business prospects, results of operations and cash flows.

Our Ability to Pay Dividends is Subject to Legal Restrictions

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

Competition Adversely Affects our Profitability

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

Government Regulation and Legislation Could Adversely Affect Us

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

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

Our Controls and Procedures May Fail or be Circumvented

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

Recent Changes in Deposit Insurance Premiums Could Adversely Affect Our Business

In 2006, the FDIC created a new assessment system designed to more closely tie what banks pay for deposit insurance to the risks they pose and adopted a new base schedule of rates that the FDIC can adjust up or down depending on the revenue needs of the insurance fund. Although an FDIC credit for prior contributions offset most of the assessment for 2007, the insurance assessments the Bank will pay has increased our costs starting in 2008. This new assessment system has resulted in annual assessments on deposits of the Bank of approximately \$419,000. Any further increases in the deposit insurance assessments the Bank pays would further increase our costs.

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

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

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

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

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

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

Changes in Accounting Standards Could Materially Impact Our Financial Statements

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

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

The Bank's allowance for estimated losses on loans was approximately \$10.9 million, or 2.13% of total loans, at December 31, 2007, compared to \$8.4 million, or 1.73% of total loans, at December 31, 2006, and 70% of total non-performing loans at December 31, 2007, compared to 243% of total non-performing loans at December 31, 2006. Material future additions to the allowance for estimated losses on loans may be necessary if material adverse changes in economic conditions occur and the performance of the Bank's loan portfolio deteriorates. In addition, an allowance for losses on other real estate owned may also be required in order to reflect changes in the markets for real estate in which the Bank's other real estate owned is located and other factors which may result in adjustments which are necessary to ensure that the Bank's foreclosed assets are carried at the lower of cost or fair value, less estimated costs to dispose of the properties. Moreover, the FDIC and the DFI, as an integral part of their examination process, periodically review the Bank's allowance for estimated losses on loans and the carrying value of its assets. Increases in the provisions for estimated losses on loans and foreclosed assets would adversely affect the Bank's financial condition and results of operations. See "Management's Discussion and Analysis of Financial Condition and Results of Operations - Summary of Loan Loss Experience" below.

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

As of December 31, 2007, the Company had 8,169,772 shares of Common Stock outstanding, all of which are eligible for sale in the public market without restriction. Future sales of substantial amounts of the Company's Common Stock, or the perception that such sales could occur, could have a material adverse effect on the market price of the Common Stock. In addition, options to acquire up to 6.5% of the unissued authorized shares of Common Stock at exercise prices ranging from \$4.03 to \$26.18 have been issued to directors and employees of the Company, over the past eight (8) years, under the Company's 2000 and 2006 Stock Option Plans and Outside Directors 2000 and 2006 Non-statutory Stock Option Plans, and options to acquire up to an additional 9.1% of the unissued authorized shares of Common Stock are reserved for issuance under such plans. No prediction can be made as to the effect, if any, that future sales of shares, or the availability of shares for future sale, will have on the market price of the Company's Common Stock. See "Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities" below.

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

The Company's common stock is not listed on any exchange, nor is it included on NASDAQ. However, trades may be reported on the OTC Bulletin Board under the symbol "FNRN". The Company is aware that Howe Barnes Hoefler & Arnett, Stone & Youngberg, Wedbush Morgan Securities and Monroe Securities, Inc., all currently make a market in the Company's common stock. Management is aware that there are also private transactions in the Company's common stock. However, the limited trading market for the Company's common stock may make it difficult for shareholders to dispose of their shares. Also, the price of the Company's common stock may be affected by general market price movements as well as developments specifically related to the financial services sector, including interest rate movements, quarterly variations, or changes in financial estimates by securities analysts and a significant reduction in the price of the stock of another participant in the financial services industry, as well as the level of repurchases of Company stock by the Company pursuant to its stock repurchase program.

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

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

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

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

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

As of December 31, 2007, the Company had outstanding options to purchase an aggregate of 511,567 shares of Common Stock at exercise prices ranging from \$4.03 to \$26.18 per share, or a weighted average exercise price per share of \$11.43. To the extent such options are exercised, shareholders of the Company will experience dilution. See "Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities" below.

ITEM 1B – UNRESOLVED STAFF COMMENTS

None.

ITEM 2 – PROPERTIES

The Company and the Bank are engaged in the banking business through 17 offices five counties in Northern California operating out of four offices in Solano County, eight in Yolo County, three in Sacramento County and two in Placer County. In addition, the Company owns four vacant lots, three in northern Solano County and one in eastern Sacramento County, for possible future bank sites. The Company and the Bank believe all of their offices are constructed and equipped to meet prescribed security requirements.

The Bank owns three branch office locations and two administrative facilities and leases 14 facilities. Most of the leases contain multiple renewal options and provisions for rental increases, principally for changes in the cost of living index, property taxes and maintenance.

ITEM 3 - LEGAL PROCEEDINGS

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

ITEM 4 - SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of the Company's shareholders during the fourth quarter of the fiscal year covered by this report.

PART II

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

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

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

QUARTER/YEAR	HIGH*	LOW*
4th Quarter 2007	\$17.83	\$14.86
3rd Quarter 2007	\$17.92	\$14.86
2nd Quarter 2007	\$18.16	\$16.36
1st Quarter 2007	\$20.92	\$17.45
4th Quarter 2006	\$23.14	\$20.25
3rd Quarter 2006	\$24.02	\$22.25
2nd Quarter 2006	\$25.81	\$23.23
1st Quarter 2006	\$25.58	\$21.20

* Price adjusted for dividends and splits.

As of December 31, 2007, there were approximately 1,218 holders of record of the Company's common stock, no par value, which is the only class of equity securities authorized or issued.

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

Shareholder Record Date	Dividend Percentage	Date Payable
February 29, 2008	6%	March 31, 2008
February 28, 2007	6%	March 30, 2007
February 28, 2006	6%	March 31, 2006

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

Purchases of Equity Securities by the Issuer or Affiliated Purchasers

On June 22, 2007, the Company approved a new stock repurchase program effective June 22, 2007 to replace the Company's previous stock repurchase plan that commenced May 1, 2006. The new stock repurchase program, which will remain in effect until June 21, 2009, allows repurchases by the Company in an aggregate of up to 4% of the Company's outstanding shares of common stock over each rolling twelve-month period. The Company repurchased 129,924 shares of the Company's outstanding common stock during the quarter ended December 31, 2007.

The Company made the following repurchases of its common stock during the quarter ended December 31, 2007:

Period	(a) Total number of shares purchased	(b) Average price paid per share	(c) Total Number of shares purchased as part of publicly announced plans or programs	(d) Maximum number of shares that may yet be purchased under the plans or programs
October 1 – October 31, 2007	4,843	\$ 18.24	4,843	209,759
November 1 – November 30, 2007	99,842	\$ 17.84	99,842	109,917
December 1 – December 31, 2007	25,239	\$ 17.40	25,239	84,678
Total	129,924	\$ 17.77	129,924	84,678

ITEM 6 - SELECTED FINANCIAL DATA

The selected consolidated financial data below have been derived from the Company's audited consolidated financial statements. The selected consolidated financial data set forth below as of December 31, 2004, and 2003 have been derived from the Company's historical financial statements not included in this Report. The financial information for 2007, 2006 and 2005 should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations," which is in Part II (Item 7) of this Report and with the Company's audited consolidated financial statements and the notes thereto, which are included in Part II (Item 8) of this Report.

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

	2007	2006	2005	2004	2003
Interest Income and Loan Fees	\$ 48,594	\$ 48,070	\$ 40,902	\$ 31,619	\$ 30,326
Interest Expense	(11,738)	(9,426)	(5,729)	(3,426)	(3,109)
Net Interest Income	36,856	38,644	35,173	28,193	27,217
Provision for Loan Losses	(4,795)	(735)	(600)	(207)	(2,153)
Net Interest Income after Provision for Loan Losses	32,061	37,909	34,573	27,986	25,064
Other Operating Income	7,160	5,289	5,720	5,214	7,160
Other Operating Expense	(28,803)	(29,219)	(26,813)	(22,943)	(22,868)
Income before Taxes	10,418	13,979	13,480	10,257	9,356
Provision for Taxes	(3,137)	(5,169)	(4,792)	(3,550)	(3,245)
Net Income	\$ 7,281	\$ 8,810	\$ 8,688	\$ 6,707	\$ 6,111
Basic Income Per Share	\$ 0.83	\$ 0.98	\$ 0.96	\$ 0.74	\$ 0.67
Diluted Income Per Share	\$ 0.80	\$ 0.94	\$ 0.92	\$ 0.72	\$ 0.66
Total Assets	\$ 709,895	\$ 685,225	\$ 660,647	\$ 629,503	\$ 559,441
Total Investments	\$ 74,849	\$ 76,273	\$ 48,788	\$ 55,154	\$ 50,235
Total Loans, including Loans Held-for-Sale, net	\$ 499,314	\$ 480,009	\$ 460,501	\$ 433,421	\$ 380,491
Total Deposits	\$ 622,671	\$ 603,682	\$ 581,781	\$ 557,186	\$ 498,849
Total Equity	\$ 63,975	\$ 61,990	\$ 56,802	\$ 51,901	\$ 46,972
Weighted Average Shares of Common Stock outstanding used for Basic Income Per Share Computation 1	8,820,846	8,958,878	9,020,678	9,074,207	9,097,007
Weighted Average Shares of Common Stock outstanding used for Diluted Income Per Share Computation 1	9,083,365	9,398,017	9,437,195	9,312,184	9,294,348

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Return on Average Total Assets	1.05%	1.32%	1.35%	1.14%	1.18%
Net Income/Average Equity	11.59%	14.90%	16.17%	13.73%	13.56%
Net Income/Average Deposits	1.19%	1.49%	1.52%	1.28%	1.32%
Average Loans/Average Deposits	79.75%	81.20%	79.44%	75.81%	79.25%
Average Equity to Average Total Assets	9.06%	8.87%	8.37%	8.32%	8.69%

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

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

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

Introduction

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

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

Financial highlights for 2007 include:

Net income for 2007 totaled \$7.28 million, a 17.4% decrease compared to \$8.81 million for 2006. Net income per common share for 2007 of \$0.83 decreased 15.3% compared to \$0.98 for 2006, and net income per common share on a fully diluted basis was \$0.80 for 2007, a decrease of 14.9% compared to \$0.94 for 2006.

Loans (including loans held-for-sale) increased to \$499.3 million at December 31, 2007, a 4.0% increase from \$480.0 million at December 31, 2006. Commercial loans totaled \$112.3 million at December 31, 2007, up 15.5% from \$97.3 million a year earlier; agriculture loans were \$36.8 million, down 4.8% from \$38.6 million at December 31, 2006; real estate construction loans were \$91.9 million, down 13.9% from \$106.8 million at December 31, 2006; and real estate mortgage loans were \$253.0 million, up 9.1% from \$232.0 million a year earlier.

Average deposits grew to \$612.8 million during 2007, a \$23.0 million or 3.9% increase from 2006.

The Company reported average total assets of \$693.4 million at December 31, 2007, up 4.1% from \$666.4 million a year earlier.

The provision for loan losses in 2007 totaled \$4,795,000, an increase of 552.4% from \$735,000 in 2006. Net charge-offs were \$2,280,000 in 2007 compared to \$291,000 in 2006. The increase in the provision for loan losses and increase in net charge-offs can be primarily attributed to increased loan volume combined with increased charge-offs.

Net interest income totaled \$36.9 million for 2007, a decrease of 4.6% from \$38.6 million in 2006, primarily due to increased deposit volumes, increased deposit rates and decreased loan rates, which was partially offset by increased loan volume.

Other operating income totaled \$7.2 million for the year ended December 31, 2007, an increase of 35.4% from \$5.3 million for the year ended December 31, 2006. The increase was due primarily to increases in service charges on deposit accounts, gains on sales of available-for-sale securities, gains on sales of loans and gains on other real estate owned.

Other operating expenses totaled \$28.8 million for 2007, down 1.4% from \$29.2 million in 2006. Contributing to the decrease was decreased salaries, which was partially offset by increased data processing expenses.

In 2008, the Company intends to continue its long-term strategy of maintaining deposit growth to fund growth in loans and other earning assets and intends to identify opportunities for growing other operating income in areas such as Asset Management and Trust and Investment and Brokerage Services, and deposit fee income, while remaining conscious of the need to maintain appropriate expense levels. We expect gradual growth in commercial and real estate loan volumes and deposit growth, assuming that inflation remains in check throughout the year. If the current flat or inverted interest rate environment continues, the Company's net interest income and net interest margin may decrease due to an increase in the cost of deposits, unless accompanied by a disproportionate increase in loan volume.

Critical Accounting Policies and Estimates

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

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

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

The allocated component of the allowance for loan losses also includes consideration of concentrations and changes in portfolio mix and volume. The general portion of the allowance reflects the Company's estimate of probable inherent but undetected losses within the portfolio due to uncertainties in economic conditions, delays in obtaining information, including unfavorable information about a borrower's financial condition, the difficulty in identifying triggering events that correlate perfectly to subsequent loss rates, and risk factors that have not yet manifested themselves in loss allocation factors. Uncertainty surrounding the strength and timing of economic cycles also affects estimates of loss. There are many factors affecting the allowance for loan losses; some are quantitative while others require qualitative judgment. Although the Company believes its process for determining the allowance adequately considers

all of the potential factors that could potentially result in credit losses, the process includes subjective elements and may be susceptible to significant change. To the extent actual outcomes differ from Company estimates, additional provision for credit losses could be required that could adversely affect earnings or financial position in future periods.

Prospective Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." SFAS No. 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS No. 157 establishes a fair value hierarchy about the assumptions used to measure fair value and clarifies assumptions about risk and the effect of a restriction on the sale or use of an asset. The standard is effective for fiscal years beginning after November 15, 2007. The Company does not expect the adoption of SFAS No. 157 to have any material impact on the Company's financial position and results of operations.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities." Under this Standard, the Company may elect to report financial instruments and certain other items at fair value on a contract-by-contract basis with changes in value reported in earnings. This election is irrevocable. SFAS No. 159 provides an opportunity to mitigate volatility in reported earnings that is caused by measuring hedged assets and liabilities that were previously required to use a different accounting method than the related hedging contracts when the complex provisions of SFAS No. 133 hedge accounting are not met. SFAS No. 159 is effective for years beginning after November 15, 2007. Early adoption within 120 days of the beginning of the Company's 2007 fiscal year is permissible, provided the Company has not yet issued interim financial statements for 2007 and has adopted SFAS No. 157. The Company does not expect the adoption of SFAS No. 159 to have any material impact on the Company's financial position and results of operations.

In September 2006, the Emerging Issues Task Force issued EITF 06-4, "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements." This consensus concludes that for split-dollar life insurance arrangements within the scope of this Issue, an employer should recognize a liability for future benefits in accordance with SFAS No. 106 (if, in substance, a postretirement benefit plan exists) or APB Opinion No. 12 (if the arrangement is, in substance, an individual deferred compensation contract) based on the substantive agreement with the employee. The consensus is effective for fiscal years beginning after December 15, 2007. The Company does not expect the adoption of EITF 06-4 to have any material impact on the Company's financial position and results of operations.

In November 2007, EITF Issue No. 07-6, Accounting for the Sale of Real Estate Subject to the Requirements of FASB Statement No. 66, Accounting for Sales of Real Estate, When the Agreement Includes a Buy-Sell Clause, was issued. The Task Force reached a consensus that a buy-sell clause in a sale of real estate that otherwise qualifies for partial sale accounting does not by itself constitute a form of continuing involvement that would preclude partial sale accounting under SFAS No. 66, Accounting for Sales of Real Estate. However, continuing involvement could be present if the buy-sell clause in conjunction with other implicit and explicit terms of the arrangement indicate that the seller has an obligation to repurchase the property, the terms of the transaction allow the buyer to compel the seller to repurchase the property, or the seller can compel the buyer to sell its interest in the property back to the seller. The consensus is effective for fiscal years beginning after December 15, 2007. The consensus applies to new assessments made under SFAS No. 66 after the consensus' effective date. The Company does not expect the adoption of EITF Issue No. 07-6 to have any material impact on the consolidated financial statements or results of operations of the Company.

In December 2007, the FASB issued SFAS No. 160, Non-controlling Interests in Consolidated Financial Statements, which will require non-controlling interests (previously referred to as minority interests) to be treated as a separate component of equity, not as a liability or other item outside of permanent equity. SFAS No. 160 applies to the accounting for non-controlling interests and transactions with non-controlling interest holders in consolidated financial statements. SFAS No. 160 is effective for periods beginning on or after December 15, 2008. Earlier application is prohibited. SFAS No. 160 will be applied prospectively to all non-controlling interests, including any that arose before the effective date except that comparative period information must be recast to classify

non-controlling interests in equity, attribute net income and other comprehensive income to non-controlling interests, and provide other disclosures required by SFAS No. 160. The Company does not expect the adoption of SFAS No. 160 to have any material impact on the consolidated financial statements or results of operations of the Company.

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

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

STATISTICAL INFORMATION AND DISCUSSION

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

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

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

	2007		2006		2005	
	Average Balance	Percent	Average Balance	Percent	Average Balance	Percent
ASSETS						
Cash and Due From Banks	\$ 32,518	4.69%	\$ 29,934	4.49%	\$ 31,287	4.87%
Federal Funds Sold	52,359	7.55%	61,904	9.29%	81,948	12.75%
Investment Securities	86,046	12.41%	64,770	9.72%	48,378	7.53%
Loans 1	488,704	70.47%	478,908	71.88%	452,646	70.46%
Stock in Federal Home Loan Bank and other equity securities, at cost	2,146	0.31%	2,087	0.31%	2,011	0.31%
Other Assets	31,666	4.57%	28,750	4.31%	26,211	4.08%
Total Assets	\$ 693,439	100.00%	\$ 666,353	100.00%	\$ 642,481	100.00%
LIABILITIES & STOCKHOLDERS' EQUITY						
Deposits:						
Demand	\$ 185,563	26.77%	\$ 187,766	28.18%	\$ 184,171	28.67%
Interest-Bearing Transaction						
Deposits	130,608	18.83%	95,180	14.28%	73,990	11.52%
Savings & MMDAs	179,425	25.87%	190,036	28.52%	190,562	29.65%
Time Certificates	117,178	16.90%	116,787	17.53%	121,067	18.84%
Borrowed Funds	10,504	1.51%	11,350	1.70%	14,320	2.23%
Other Liabilities	7,347	1.06%	6,113	0.92%	4,627	0.72%
Stockholders' Equity	62,814	9.06%	59,121	8.87%	53,744	8.37%
Total Liabilities & Stockholders' Equity	\$ 693,439	100.00%	\$ 666,353	100.00%	\$ 642,481	100.00%

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

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

	2007			2006			2005		
Assets	Average Balance	Interest Income/Expense	Yields Earned/Rates Paid	Average Balance	Interest Income/Expense	Yields Earned/Rates Paid	Average Balance	Interest Income/Expense	Yields Earned/Rates Paid
Loans 1	\$ 488,704	\$ 39,220	8.03%	\$ 478,908	\$ 39,082	8.16%	\$ 452,646	\$ 32,808	7.25%
Loan Fees	—	2,268	0.46%	—	2,812	0.59%	—	3,030	0.67%
Total Loans, Including Loan Fees	488,704	41,488	8.49%	478,908	41,894	8.75%	452,646	35,838	7.92%
Federal Funds Sold	52,359	2,660	5.08%	61,904	2,986	4.82%	81,948	2,587	3.16%
Due From Banks	5,922	273	4.61%	—	—	—	—	—	—
Investment Securities:									
Taxable	56,350	2,789	4.95%	50,958	2,448	4.80%	36,622	1,834	5.01%
Non-taxable ²	29,696	1,271	4.28%	13,812	636	4.60%	11,756	562	4.78%
Total Investment Securities	86,046	4,060	4.72%	64,770	3,084	4.76%	48,378	2,396	4.95%
Other Earning Assets	2,146	113	5.27%	2,087	106	5.08%	2,011	81	4.03%
Total Earning Assets	635,177	\$ 48,594	7.65%	607,669	\$ 48,070	7.91%	584,983	\$ 40,902	6.99%
Cash and Due from Banks	26,596			29,934			31,287		
Premises and Equipment	8,123			8,188			7,743		
Interest Receivable									

and Other Assets	23,543	20,562	18,468
Total Assets	\$ 693,439	\$ 666,353	\$ 642,481

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

thereon is excluded.

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

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

Liabilities and Stockholders' Equity	2007			2006			2005		
	Average Balance	Interest Income/ Expense	Yields Earned/ Rates Paid	Average Balance	Interest Income/ Expense	Yields Earned/ Rates Paid	Average Balance	Interest Income/ Expense	Yields Earned/ Rates Paid
Interest-Bearing Deposits:									
Interest-Bearing Transaction Deposits	\$ 130,608	\$ 2,840	2.17%	\$ 95,180	\$ 1,568	1.65%	\$ 73,990	\$ 512	0.69%
Savings & MMDAs	179,425	4,034	2.25%	190,036	3,813	2.01%	190,562	2,279	1.20%
Time Certificates	117,178	4,551	3.88%	116,787	3,682	3.15%	121,067	2,443	2.02%
Total Interest-Bearing Deposits	427,211	11,425	2.67%	402,003	9,063	2.25%	385,619	5,234	1.36%
Borrowed Funds	10,504	313	2.98%	11,350	363	3.20%	14,320	495	3.46%
Total Interest-Bearing Deposits and Funds	437,715	11,738	2.68%	413,353	9,426	2.28%	399,939	5,729	1.43%
Demand Deposits	185,563	—	—	187,766	—	—	184,171	—	—
Total Deposits and Borrowed Funds	623,278	\$ 11,738	1.88%	601,119	\$ 9,426	1.57%	584,110	\$ 5,729	0.98%
Accrued Interest and Other Liabilities	7,347			6,113			4,627		
Stockholders' Equity	62,814			59,121			53,744		

Total Liabilities and Stockholders' Equity	\$ 693,439		\$ 666,353		\$ 642,481	
Net Interest Income and Net Interest Margin 1	\$ 36,856	5.80%	\$ 38,644	6.36%	\$ 35,173	6.01%
Net Interest Spread 2		4.97%		5.63%		5.56%

1. Net interest margin is computed by dividing net interest income by total average interest-earning assets.
2. Net interest spread represents the average yield earned on interest-earning assets less the average rate paid on interest-bearing liabilities.

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

Following is an analysis of changes in interest income and expense (dollars in thousands) for 2007 over 2006 and 2006 over 2005. Changes not solely due to interest rate or volume have been allocated proportionately to interest rate and volume.

	2007 Over 2006			2006 Over 2005		
	Volume	Interest Rate	Change	Volume	Interest Rate	Change
Increase (Decrease) in Interest Income:						
Loans	\$ 626	\$ (488)	\$ 138	\$ 1,983	\$ 4,291	\$ 6,274
Loan Fees	(544)	—	(544)	(218)	—	(218)
Federal Funds Sold	(502)	176	(326)	(347)	746	399
Due From Banks	273	—	273	—	—	—
Investment Securities	1,002	(26)	976	784	(96)	688
Other Assets	3	4	7	3	22	25
	\$ 858	\$ (334)	\$ 524	\$ 2,205	\$ 4,963	\$ 7,168
Increase (Decrease) in Interest Expense:						
Deposits:						
Interest-Bearing Transaction Deposits	\$ 689	\$ 583	\$ 1,272	\$ 180	\$ 876	\$ 1,056
Savings & MMDAs	(194)	415	221	(6)	1,540	1,534
Time Certificates	12	857	869	(83)	1,322	1,239
Borrowed Funds	(26)	(24)	(50)	(97)	(35)	(132)
	\$ 481	\$ 1,831	\$ 2,312	\$ (6)	\$ 3,703	\$ 3,697
Increase (Decrease) in Net Interest Income	\$ 377	\$ (2,165)	\$ (1,788)	\$ 2,211	\$ 1,260	\$ 3,471

Financial Condition

Summary

Year Ended December 31, 2007 Compared to Year Ended December 31, 2006

Total assets increased by \$24.7 million, or 3.6%, to \$709.9 million as of December 31, 2007 compared to \$685.2 million at December 31, 2006. The increase in total assets was mainly due to a \$19.3 million growth in net loans (including loans held-for-sale) and a \$16.6 million increase in cash and due from banks offset by a 15.5 million reduction in federal funds sold. The growth in total assets was financed primarily by the increase in deposits of \$19.0 million and other borrowings of \$4.9 million.

Year Ended December 31, 2006 Compared to Year Ended December 31, 2005

Total assets increased by \$24.6 million, or 3.7%, to 685.2 million as of December 31, 2006 compared to \$660.6 million at December 31, 2005. The increase in total assets was mainly due to a \$19.5 million growth in net loans (including loans held-for-sale) and a \$27.5 increase in investment securities available-for-sale offset by a \$24.7 million reduction in federal funds sold. The growth in total assets was financed primarily by the increase in deposits of \$21.9 million.

INVESTMENT PORTFOLIO

Composition of Investment Securities

The mix of investment securities held by the Company at December 31, for the previous three fiscal years is as follows (dollars in thousands):

	2007	2006	2005
Investment securities available for sale:			
U.S. Treasury Securities	\$ 263	\$ 253	\$ 250
Securities of U.S. Government Agencies and Corporations	20,139	31,703	21,556
Obligations of State & Political Subdivisions	37,057	30,193	23,047
Mortgage Backed Securities	17,390	12,031	1,803
Total Investments	\$ 74,849	\$ 74,180	\$ 46,656

Maturities of Investment Securities

The following table is a summary of the relative maturities (dollars in thousands) and yields of the Company's investment securities as of December 31, 2007. The yields on tax-exempt securities are shown on a tax equivalent basis.

Security	Period to Maturity					
	Within One Year		After One But Within Five Years		After Five But Within Ten Years	
	Amount	Yield	Amount	Yield	Amount	Yield
U.S. Treasury Securities	\$ —	—	\$ 263	5.00%	\$ —	—
Securities of U.S. Government Agencies and Corporations	6,980	4.06%	13,159	4.56%	—	—
Obligations of State & Political Subdivisions	3,857	7.42%	5,312	7.34%	10,175	6.62%
Mortgage Backed Securities	19	7.00%	15,423	5.17%	1,948	5.22%
TOTAL	\$ 10,856	5.26%	\$ 34,157	5.27%	\$ 12,123	6.39%

Security	After Ten Years		Total	
	Amount	Yield	Amount	Yield
U.S. Treasury Securities	\$ —	—	\$ 263	5.00%
Securities of U.S. Government Agencies and Corporations	—	—	20,139	4.39%
Obligations of State & Political Subdivisions	17,713	6.41%	37,057	6.71%
Mortgage Backed Securities	—	—	17,390	5.18%

TOTAL	\$ 17,713	6.41%	\$ 74,849	5.72%
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LOAN PORTFOLIO

Composition of Loans

The mix of loans, net of deferred origination fees and costs and allowance for loan losses and excluding loans held-for-sale, at December 31, for the previous five fiscal years is as follows (dollars in thousands):

	2007		December 31, 2006		2005	
	Balance	Percent	Balance	Percent	Balance	Percent
Commercial	\$ 112,295	22.6%	\$ 97,268	20.5%	87,091	19.1%
Agriculture	36,772	7.4%	38,607	8.1%	32,808	7.2%
Real Estate Mortgage	251,672	50.5%	227,552	47.9%	228,524	50.1%
Real Estate Construction	91,901	18.4%	106,752	22.4%	103,422	22.7%
Installment	5,331	1.1%	5,370	1.1%	4,216	0.9%
TOTAL	\$ 497,971	100.0%	\$ 475,549	100.0%	\$ 456,061	100.0%

	2004		2003	
	Balance	Percent	Balance	Percent
Commercial	\$ 89,721	20.9%	\$ 88,949	24.1%
Agriculture	32,910	7.7%	32,766	8.9%
Real Estate Mortgage	216,846	50.4%	174,867	47.2%
Real Estate Construction	85,584	19.9%	68,370	18.5%
Installment	4,641	1.1%	4,867	1.3%
TOTAL	\$ 429,702	100.0%	\$ 369,819	100.0%

Commercial loans are primarily for financing the needs of a diverse group of businesses located in the Bank's market area. The Bank also makes loans to individuals for investment purposes. Most of these loans are relatively short-term (an overall average life of approximately two years) and secured by various types of collateral. Real estate construction loans are generally for financing the construction of single-family residential homes for well-qualified individuals and builders. These loans are secured by real estate and have short maturities.

As shown in the comparative figures for loan mix during 2007 and 2006, total loans increased as a result of increases in commercial loans and real estate mortgage loans which were partially offset by a decrease in agriculture loans, real estate construction loans and installment loans.

On February 13, 2008, President Bush signed into law the Economic Stimulus Act of 2008 which, among other provisions, authorizes the three federal mortgage loan conduits, the Federal National Mortgage Association (known as Fannie Mae), the Federal Home Loan Mortgage Corporation (known as Freddie Mac) and the Federal Housing Administration, to purchase new and existing "jumbo" residential mortgage loans originated after June 30, 2007. The legislation, which will go into operation when the federal mortgage agencies calculate and publish new loan limits for each Standard Metropolitan Statistical Area, based on average housing prices, will increase the current limit on conforming loans which can be purchased by Fannie Mae and Freddie Mac to up to \$729,750 from its current

maximum of \$417,000. The purpose of the increased purchase authority, which will apply to loans originated through the end of 2008, is to provide increased liquidity to the secondary market for "jumbo" residential loans. Loans on residential properties in a number of counties in the State of California where housing prices remain relatively high will be covered by the increased purchase authority. This could result in an increased rate of loan originations and refinancings of loans on such properties, including properties securing loans made by the Bank. The degree to which this will occur and its overall effect on the Bank's residential mortgage loan portfolio cannot be determined at this time.

Maturities and Sensitivities of Loans to Changes in Interest Rates

Loan maturities of the loan portfolio at December 31, 2007 are as follows (dollars in thousands) (excludes loans held-for-sale):

	Maturing	Fixed Rate	Variable Rate	Total
Within one year		\$ 42,279	\$ 171,131	\$ 213,410
After one year through five years		64,462	109,411	173,873
After five years		25,199	85,489	110,688
Total		\$ 131,940	\$ 366,031	\$ 497,971

Non-accrual, Past Due and Restructured Loans

It is the Bank's policy to recognize interest income on an accrual basis. Accrual of interest is suspended when a loan has been in default as to principal or interest for 90 days, unless well secured by collateral believed by management to have a fair market value that at least equals the book value of the loan plus accrued interest receivable and in the process of collection. Real estate acquired through foreclosure is written down to its estimated fair market value at the time of acquisition and is carried as a non-earning asset until sold. Any write-down at the time of acquisition is charged against the allowance for loan losses; subsequent write-downs or gains or losses upon disposition are credited or charged to non-interest income/expense. The Bank has made no foreign loans.

The following table shows the aggregate amounts of assets (dollars in thousands) in each category at December 31, for the years indicated:

	2007	2006	2005	2004	2003
Non-accrual Loans	\$ 15,173	\$ 3,399	\$ 2,073	\$ 4,907	\$ 3,877
90 Days Past Due But Still Accruing	263	37	178	55	4
Total Non-performing Loans	15,436	3,436	2,251	4,962	3,881
Other Real Estate Owned	879	375	268	—	—
Total Non-performing Assets	\$ 16,315	\$ 3,811	\$ 2,519	\$ 4,962	\$ 3,881

If interest on non-accrual loans had been accrued, such interest income would have approximated \$814,000, \$280,000, and \$101,000 during the years ended December 31, 2007, 2006 and 2005, respectively. Income actually recognized for these loans approximated \$73,000, \$113,000 and \$100,000 for the years ended December 31, 2007, 2006 and 2005, respectively.

There was a \$12,504,000 increase in non-performing assets for 2007 over 2006. At December 31, 2007, non-performing assets included three non-accrual commercial loans totaling \$511,000, four non-accrual agricultural loans totaling \$1,504,000, three non-accrual commercial real estate loans totaling \$3,816,000, twelve non-accrual residential mortgage loans totaling \$9,335,000 and one non-accrual installment loan totaling \$7,000. Additional non-performing assets included two loans past due more than 90 days totaling \$263,000. Other Real Estate Owned

("OREO") properties totaled \$879,000 at December 31, 2007. The Bank's management believes that nearly \$14,902,000 of the \$15,173,000 in non-accrual loans at December 31, 2007, was adequately collateralized or guaranteed by a governmental entity, and the remaining \$271,000 may have some potential loss which management believes is sufficiently covered by the Bank's existing loan loss reserve (Allowance for Loan Losses).

Potential Problem Loans

In addition to the non-performing assets described above, the Bank's Branch Managers each month submit to the Loan Committee of the Board of Directors a report detailing the status of those loans that are past due over sixty days and each quarter a report detailing the status of those loans that are classified as such. Also included in the report are those loans that are not necessarily past due, but the branch manager is aware of problems with these loans which may result in a loss.

The monthly Allowance for Loan Loss Analysis Report is prepared based upon the Problem Loan Report, internal loan rating, regulatory classifications and loan review classification and is reviewed by the Management Loan Committee of the Bank. The Management Loan Committee reviewed the Allowance for Loan Loss Analysis Report, dated December 31, 2007, on January 15, 2008. This report included all non-performing loans reported in the table on the previous page and other potential problem loans. Excluding the non-performing loans cited previously, loans totaling \$19,665,000 were classified as potential problem loans. The Bank's management believes that of these loans, loans totaling \$17,902,000 are adequately collateralized or guaranteed, and the remaining loans totaling \$1,763,000 may have some loss potential which management believes is sufficiently covered by the Bank's existing loan loss reserve (Allowance for Loan Losses). The ratio of the Allowance for Loan Losses to total loans at December 31, 2007 was 2.13%.

SUMMARY OF LOAN LOSS EXPERIENCE

The Allowance for Loan Losses is maintained at a level believed by management to be adequate to provide for losses that can be reasonably anticipated. The allowance is increased by provisions charged to operating expense and reduced by net charge-offs. The Bank makes credit reviews of the loan portfolio and considers current economic conditions, loan loss experience, and other factors in determining the adequacy of the allowance for loan losses. The allowance for loan losses is based on estimates, and actual losses may vary from current estimates.

Analysis of the Allowance for Loan Losses
(Dollars in thousands)

	2007	2006	2005	2004	2003
Balance at Beginning of Year	\$ 8,361	\$ 7,917	\$ 7,445	\$ 7,006	\$ 6,630
Provision for Loan Losses	4,795	735	600	207	2,153
Loans Charged-Off:					
Commercial	(1,428)	(572)	(670)	(122)	(143)
Agriculture	(82)	(57)	—	(214)	(1,662)
Real Estate Mortgage	(249)	—	—	—	—
Real Estate Construction	(537)	—	—	—	—
Installment Loans to Individuals	(764)	(431)	(185)	(46)	(104)
Total Charged-Off	(3,060)	(1,060)	(855)	(382)	(1,909)
Recoveries:					
Commercial	256	561	64	199	101
Agriculture	200	—	663	399	11
Installment Loans to Individuals	324	208	—	16	20

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Total Recoveries	780	769	727	614	132
Net (Charge-Offs) Recoveries	(2,280)	(291)	(128)	232	(1,777)
Balance at End of Year	\$ 10,876	\$ 8,361	\$ 7,917	\$ 7,445	\$ 7,006