MONTEREY BAY BANCORP INC
Form 10-K
March 22, 2001

SECURITIES AND EXCHANGE COMMISSION
Washington, DC 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, 2000

Commission File Number: 0-24802

MONTEREY BAY BANCORP, INC.
(Exact Name Of Registrant As Specified In Its Charter)

DELAWARE	77-0381362
(State Or Other Jurisdiction Of Incorporation Or Organization)	(I.R.S. Employer Identification Number)

567 Auto Center Drive, Watsonville, California 95076
(Address Of Principal Executive Offices)(Zip Code)

(831) 768 - 4800
(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, $0.01 par value per share
(Title Of Class)

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the 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. [ ]

The aggregate market value of the Common Stock held by "non-affiliates" of the registrant, based upon the closing sale price of its Common Stock on March 5, 2001, as quoted on the Nasdaq National Market System, was approximately $20,944,000. Shares of common stock held by each officer, director, and holder of 5% or more of the outstanding Common Stock have been excluded in that such persons or entities may be deemed to be affiliates. Such determination of affiliate status is not necessarily a conclusive determination for other purposes.

The registrant had 3,419,764 shares of Common Stock outstanding as of March 6, 2001.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement for the 2001 Annual Meeting of Stockholders to be filed within 120 days of the fiscal year ended December 31, 2000 are incorporated by reference into Part III of this Form 10-K.

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PART I

Discussions of certain matters in this Annual Report on Form 10-K may constitute forward-looking statements within the meaning of the Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities and Exchange Act of 1934, as amended (the "Exchange Act"), and as such, may involve risks and uncertainties. Forward-looking statements, which are based on certain assumptions and describe future plans, strategies, and expectations, are generally identifiable by the use of words or phrases such as "believe", "expect", "intend", "anticipate", "estimate", "project", "forecast", "may increase", "may fluctuate", "may improve" and similar expressions or future or conditional verbs such as "will", "should", "would", and "could". These forward-looking statements relate to, among other things, expectations of the business environment in which Monterey Bay Bancorp, Inc. operates, projections of future performance, potential future credit experience, perceived opportunities in the market, and statements regarding the Company's mission and vision. The Company's actual results, performance, and achievements may differ materially from the results, performance, and achievements expressed or implied in such forward-looking statements due to a wide range of factors. For a discussion of some of the factors that might cause such a difference, including, but not limited to, changes in interest rates, general economic conditions, technology, legislative and regulatory changes, monetary and fiscal policies of the US Government, US Treasury, and Federal Reserve, real estate valuations, the availability and price of energy in California, and competition in the financial services industry, see "Item 1. Business - Factors That May Affect Future Results." These factors should be considered in evaluating the forward-looking statements, and undue reliance should not be placed on such statements. The Company does not undertake, and specifically disclaims any obligation, to update any forward-looking statements to reflect occurrences or unanticipated events or circumstances after the date of such statements.

Item 1. Business.

General

Monterey Bay Bancorp, Inc. (referred to herein on an unconsolidated basis as "MBBC" and on a consolidated basis as the "Company") is a unitary savings and loan holding company incorporated in 1994 under the laws of the state of Delaware. MBBC currently maintains a single subsidiary company, Monterey Bay Bank (the "Bank"), formerly Watsonville Federal Savings and Loan Association. MBBC was organized as the holding company for the Bank in connection with the Bank's conversion from the mutual to stock form of ownership in 1995.

At December 31, 2000, the Company had $486.2 million in total assets, $391.8 million in net loans receivable, and $407.8 million in total deposits. The Company is subject to regulation by the Office of Thrift Supervision ("OTS"), the Federal Deposit Insurance Corporation ("FDIC"), and the Securities and Exchange Commission ("SEC"). The principal executive offices of the Company and the Bank are located at 567 Auto Center Drive, Watsonville, California, 95076, telephone number (831) 768 - 4800, facsimile number (831) 722 - 6794. The Company may also be contacted via electronic mail at: INFO@MONTEREYBAYBANK.COM. Information concerning the Company may be accessed at the following Internet site: WWW.MONTEREYBAYBANK.COM. The Bank is a member of the Federal Home Loan Bank of San Francisco ("FHLB") and its deposits are insured by the FDIC to the maximum extent permitted by law.

The Company conducts business from eight branch offices and its administrative headquarters. In addition, the Company supports its customers through Internet Banking, 24 hour telephone banking, courier service, mail, and ATM access through 11 owned ATM's and an array of ATM networks including STAR, CIRRUS, and PLUS.

Through its network of banking offices, the Bank emphasizes personalized service focused upon three primary markets: households, professionals, and small businesses. The Bank offers a wide complement of lending products, including:

- o a broad array of residential mortgage products, both fixed and adjustable rate

- consumer loans, including home equity lines of credit and overdraft lines of credit

- specialized financing programs to support community development

- mortgages for multifamily real estate

- commercial and industrial real estate loans

- construction lending for single family residences, apartment buildings, and commercial real estate

- commercial loans to businesses, including both revolving lines of credit and term loans

The Bank also provides an extensive selection of deposit instruments. These include:

- multiple checking products for both personal and business accounts, with imaged statements available

- various savings accounts

- tiered money market accounts offering a variety of access methods

- tax qualified deposit accounts (e.g. IRA's)

- a broad array of certificate of deposit products

Through its wholly-owned subsidiary, Portola Investment Corporation ("Portola"), the Bank provides, on an agency basis, mortgage life insurance, fire insurance, and a wide selection of non-FDIC insured investment products including:

- fixed annuities

- variable annuities

- an extensive inventory of mutual funds

- individual fixed income and equity securities

Please see "Subsidiary Activities" for additional information regarding business activities by Portola.

The Bank also supports its customers by functioning as a federal tax depository, selling and purchasing foreign banknotes, issuing debit cards, providing domestic and international collection services, and supplying various forms of electronic funds transfer.

The Company participates in the wholesale capital markets through the management of its security portfolio and its use of various forms of wholesale funding. The Company's security portfolio contains a variety of instruments, including collateralized mortgage obligations ("CMO's"). The Company also participates in the secondary market for loans as both a purchaser and a seller of various types of loan products.

The Company's revenues are primarily derived from interest on its loan and mortgage backed securities portfolios, interest and dividends on its investment securities, and fee income associated with the provision of various customer services. Interest paid on deposits and borrowings constitutes the Company's largest type of expense. The Company's primary sources of funds are deposits, principal and interest payments on its asset portfolios, and various sources of wholesale borrowings including FHLB advances and securities sold under agreements to repurchase. The Company's most significant operating expenditures are its staffing expenses and the costs associated with maintaining its branch network.

Additional information concerning the Company's business is presented under "Item 7. Management's Discussion And Analysis Of Financial Condition And Results Of Operations."

Company Strategy

During the past several years, the Company has adopted a business strategy of evolving away from its traditional savings and loan roots toward a community commercial banking orientation. This evolution was selected so that the Company might better and more completely serve the financial needs of the communities it serves and because of the constrained financial returns associated with the traditional thrift business of funding residential mortgage loans with certificates of deposit. In addition, the Company believes that successful community commercial banks generally receive a more favorable valuation in the capital markets than savings and loans, thus providing a means to enhance stockholder value.

The Company's community commercial banking strategy incorporates a balance sheet profile presenting loan and deposit portfolios diversified among multiple products, a relationship based approach to customer service and marketing, and a high level of community involvement and visibility by the Company, its Directors, and its employees. As discussed below and throughout this Annual Report, the Company has achieved progress in these regards over the past several years, including some particular accomplishments in 2000.

At December 31, 2000, residential mortgage loans comprised 37.8% of total gross loans held for investment. This compares to 43.4% at December 31, 1999 and is down significantly from 70.2% at the end of 1997. This shift in mix was accomplished through the Company's emphasis upon originating and purchasing, in particular, income property loans. Income property loans include both loans secured by multifamily real estate (e.g. apartments) and by commercial and industrial real estate (e.g. retail and office buildings). Increasing construction lending constitutes another segment of the Company's business strategy, although construction loans outstanding declined during 2000 due to an insufficient inflow of new projects to offset the completion of projects under construction at the end of 1999. Construction lending opportunities are influenced by a number of factors outside the Company's control, including the availability of local building permits, water, sewer, and energy services, the general level of interest rates, market demand for new construction, and competition.

At December 31, 2000, certificates of deposits constituted 60.0% of the deposit portfolio, down from 60.5% at December 31, 1999 and 79.3% at the end of 1997. Certificates of deposit would have reflected a smaller percentage of the deposit portfolio at December 31, 2000 if not for the Bank's acquiring $14.0 million in certificates of deposit through the State of California Time Deposit Program during 2000, whereby the State of California makes deposits available to support bank reinvestment back into California communities. Over the past several years, the Company has emphasized checking and money market accounts in its marketing, new product development, and advertising as a means of cementing its relationship with its customers, decreasing its relative cost of funds, and bolstering non-interest income.

The Company's strategy of transitioning into more of a community commercial bank also incorporates increasing the percentage of the Company's total revenues generated from fees and service charges, as compared to net interest income. In this regard, the Company has expanded its scope of fee based services, altered its pricing, and enhanced the product line offered through Portola.

Another aspect of the Company's strategy is to enhance stockholder value. During 2000, the Company repurchased 120,000 of its shares at prices below tangible book value. Also during 2000, Directors determined to be paid their director fees in Company common stock, and in early 2001 the Company adopted new Bylaws that specify a minimum stock ownership requirement for all Directors. A significant portion of the total compensation for the Company's senior management is stock-based. In 2000, shares of the Company's stock were used in lieu of cash as incentive compensation for various Bank middle and senior management. Senior management change in control contracts were modified during 2000 to present what the Company believed was a better balance between the need to attract and retain well qualified employees and stockholder interests.

During 2000 and in early 2001, the Company achieved a number of key objectives in attracting the human resources and building the operational foundation it believes important to successfully advance its strategy.

A majority of the Bank's senior management team has changed in the past fifteen months, with the profile of the new officers including extensive experience in commercial banking and financial services. These new officers generally present a broad background in multiple functional areas, and have proven track records of success. The composition of the Board of Directors has also changed during the past fifteen months, with two Directors electing Emeritus status in 2000 and two additional Directors planning to elect Emeritus status at the 2001 annual meeting of stockholders. Two new Directors have been named since December 31, 1999, both of whom present professional backgrounds and managerial skills complementary to the Company's strategic plan.

Throughout 2000, the Company maintained its commitment to support the quality of life in the Greater Monterey Bay Area. Employees are encouraged to be involved with local community and service organizations. The Company continued its participation in the United Way Program. A significant contribution was made to advance post-secondary education, and other charitable donations of funds or services were conducted throughout the year.

During 2000, the Bank signed an agreement to convert to a new core processing platform based upon a leading relational database and client / server technology. This new system will process the Bank's loan and deposit accounts, among other applications, and constitutes a significant technological advancement over the prior system. The new system also provides the capability to offer a wider variety of financial products and services more efficiently than the technology utilized over the past several years. The Company intends to convert to the new system sometime during the first half of 2001. The Company also intends to complement this new system before the end of 2001 with improved ancillary operations, including a revised item processing environment.

At the beginning of 2001, the Bank added and relocated employees to support expanded sales to two key markets: professionals and businesses. A Professional Banking Group was established to conduct focused marketing to accountants, attorneys, doctors, and similar professionals. The aforementioned system conversion is planned to provide a broader product line and more attractive customer service options to these customers. A Commercial Lending

Group was established to concentrate on the growing number of small to medium sized businesses in the Company's primary market areas. This Group was staffed with two veteran commercial bankers, one of whom has extensive experience servicing businesses in the Company's markets. The Company's marketing efforts were enhanced to target sales efforts on those professionals and businesses presenting a profile that suggested the opportunity to establish more comprehensive and longer lasting financial services relationships.

In implementing its strategy, the Company also intends to enhance the services provided to its historic consumer market. The introduction of Internet banking during 2000, including electronic bill payment, is planned to be augmented by an improved consumer product line following the conversion to the new core processing platform. Planned enhancements include more rate tiers on a wider variety of deposit products, bilingual (English and Spanish) telephone banking, and better positioned and delivered money market accounts.

The implementation of this strategy presents various costs and risks. In general, the Company has had to incur operating and capital expenses in advance of associated revenues, as the human and technology resources necessary to implement the strategic plan must be in place before new sales are generated. The amount of change concomitant with this strategy, particularly given the relatively rapid pace of implementation undertaken by the Company, presents significant execution risks. These execution risks include, for example, the exposure in a comprehensive conversion to a new data processing platform and the credit risk inherent in consumer and commercial (versus mortgage) lending. The Company has endeavored to mitigate these risks, in part, by attracting the aforementioned senior officer team. The new senior management team contains individuals with significant experience in credit administration, sales management, and commercial banking. The Company's senior officers also have prior experience in tactical and strategic transactions designed to maximize stockholder value. The Company has also sought to mitigate the risks inherent in its strategic plan by hiring certain consultants to provide technical assistance and asset quality review.

In 2001, the Company intends to continue pursuing this strategy, while seeking avenues for further growth in market share and product diversification. Management believes that the continued consolidation occurring in the financial services industry may present opportunities to acquire personnel, branches, and customers from institutions being sold.

Market Area and Competition

Market Area. The Bank is a community-oriented financial institution which originates residential, multifamily, construction, commercial real estate, consumer, and business loans within its market area. The Bank's deposit gathering and lending markets are concentrated primarily in the communities surrounding its full service offices in the counties of Santa Cruz, Monterey, and Santa Clara in Central California. The economy in the Company's primary market areas has historically been primarily agricultural. However, in recent years, other economic segments have assumed a larger portion of total business activity, caused in part by the continuing southward expansion of the San Francisco Bay Area in general and the technology focused Silicon Valley community in particular. These newer and in some cases relatively rapidly expanding segments include:

- an increasing professional presence, both in commercial property and in residential housing, as the technology companies expand southward, primarily down the Highway 101 corridor

- light manufacturing
- post-secondary education
- tourism, especially in the coastal communities on Monterey Bay

The Company believes that the primary market areas in which it operates have experienced strong growth and favorable economic activity in the past several years, as reflected in appreciating real estate values and continued significant consumer demand for housing. However, in late 2000 and early 2001, the Company noted some slowing in the local economy, likely in part due to the decline of many technology companies during that time frame and the significant reduction in the NASDAQ stock market index that occurred in the latter half of 2000. The Company believes the local economy benefited in 1999 and the first half of 2000 from the significant stock and stock option wealth created by the surge in market capitalization for many technology firms.

The Company's local market areas were also impacted in early 2001 by the California energy crisis. The uncertain supply of electricity and higher cost of electricity and natural gas impacted both businesses and consumers. Businesses that are relatively energy intensive, including certain agricultural products (e.g. hot houses heated with natural gas), were adversely impacted by higher energy prices combined with a limited ability to increase product prices to reflect greater costs. Consumers experiencing higher energy bills had less disposable income to spend in the local economy. Management has particular concern about the possible energy situation in the summer of 2001, when California energy demand typically increases to peak levels. While the State of California government is working to address the energy crisis, management is unable to predict what, if any, resolution may ultimately be effected.

The Company has taken steps to reduce its energy consumption, including a reduction in exterior lighting and electric signage, reduced interior lighting in certain areas, and proactive efforts to power off inactive computers and other machines. The Company maintains a natural gas fueled generator at its administrative headquarters designed to keep the Bank's computer network operational in the event of a power reduction or outage.

In late 2000 and early 2001, many large national corporations began announcing the largest layoffs in several years. In addition, many local technology companies were shutting down due to a combination of weak (or negative) earnings and a lack of access to additional capital. While demand for labor generally remained favorable in Central California at the end of 2000, these recent trends present the potential for a slowing economy in 2001.

The economy in some segments of the Company's primary market area remains seasonal. These segments include tourism and agriculture, both of which slow during the winter months.

Competition. The banking and financial services business in California generally, and in the Bank's market areas specifically, is highly competitive. The increasingly competitive environment is a result of many factors including, but not limited to:

- the rise of the Internet, whereby the Bank must more frequently compete with remote entities soliciting customers in its primary market areas via web based advertising and product delivery, especially for certificates of deposit and residential mortgages

- the significant consolidation among financial institutions which has occurred over the past several years, resulting in a number of substantially larger competitors

- the increasing integration among commercial banks, insurance companies, securities brokers, and investment banks

- the continued growth and market share of non-bank financial services providers that often specialize in a single product line such as credit cards or residential mortgages

- the introduction of new technologies which may bypass the traditional banking system for funds settlement

- the addition of bank subsidiaries by firms not historically in the financial services business, but with significant consumer reach, including Safeway (supermarkets), Nordstrom (department stores), and State Farm Insurance

The Company competes for loans, deposits, fee based products, and customers for financial services with commercial banks, savings and loans, credit unions, thrift and loans, mortgage bankers, securities and brokerage companies, insurance firms, finance companies, mutual funds, and other non-bank financial services providers. Many of these competitors are much larger than the Bank in total assets, market reach, and capitalization; and enjoy greater access to capital markets and can offer a broader array of products and services than the Bank presently markets.

Two firms present particular competition to the Company. Both Greater Bay Bancorp, Inc. and Pacific Capital Bancorp, Inc. follow the "super community banking" model, whereby multiple community banks are owned and operated under a unified umbrella organization. Both of these firms have expanded rapidly in recent years and have acquired community banks in the Company's primary areas. Both of these firms have comparatively highly valued common stock and access to far greater amounts of capital than the Company. These firms also benefit from greater economies of scale than the Company. Acquisitions by Greater Bay Bancorp, Inc. and Pacific Capital Bancorp, Inc. have left the Company as the largest local financial institution in many of its markets.

In order to compete with other financial services providers, the Company relies upon:

- local community involvement, contributions, and visibility

- personal service and the resulting personal relationships of its staff and customers

- the development and sale of specialized products and services tailored to meet its customers' needs

- local and fast decision making

In addition, management considers the Company's reputation for financial strength and competitive services, as developed over 75 years of local Company history, as a competitive advantage in attracting and retaining customers within its primary market area.

Risk Factors That May Affect Future Results

The following discusses certain factors that may affect the Company's financial results and operations and should be considered in evaluating the Company.

Ability Of The Company To Execute Its Business Strategy. The financial performance and profitability of the Company will depend, in large part, on its ability to favorably execute its business strategy in converting from a relatively traditional savings and loan association to a community based financial services firm. This evolution entails risks in, among other areas, technology implementation, market segmentation, brand identification, banking operations, and capital and human resource investments. Accordingly, there can be no assurance that the Company will be successful in its business strategy.

Economic Conditions And Geographic Concentration. The Company's operations are located in Central and Northern California and are concentrated in Santa Cruz, Monterey, and Santa Clara Counties. Although management has diversified the Company's loan portfolio into other California counties, and to a very limited extent into other states, the vast majority of the Company's credits remain concentrated in the three primary counties. As a result of this geographic concentration, the Company's results depend largely upon economic and real estate market conditions in these areas. A deterioration in economic or real estate market conditions in the Company's primary market areas could have a material adverse impact on the quality of the Company's loan portfolio, the demand for its products and services, and its financial condition and results of operations. In addition, because the Company does not require earthquake insurance in conjunction with its real estate lending, an earthquake with an epicenter in or near the Company's primary market areas could also significantly adversely impact the Company's financial condition and results of operations.

Interest Rates. By nature, all financial institutions are impacted by changing interest rates, due to the impact of such upon:

- the demand for new loans
- prepayment speeds experienced on various asset classes, particularly mortgage backed securities and residential loans
- credit profiles of existing borrowers
- rates received on loans and securities
- rates paid on deposits and borrowings

As presented under "Item 7. Management's Discussion And Analysis Of Financial Condition And The Results Of Operations" and under "Item 7a. Quantitative And Qualitative Disclosure Of Market Risk", the Company is financially exposed to parallel shifts in general market interest rates, changes in the relative pricing of the term structure of general market interest rates, and relative credit spreads. Therefore, significant fluctuations in interest rates may present an adverse effect upon the Company's financial condition and results of operations.

Government Regulation And Monetary Policy. The financial services industry is subject to extensive federal and state supervision and regulation. Significant new laws, changes in existing laws, or repeals of present laws could cause the Company's financial results to materially differ from past results. Further, federal monetary policy, particularly as implemented through the Federal Reserve System, significantly affects credit conditions for the Company, and a material change in these conditions could present an adverse impact on the Company's financial condition and results of operations.

Competition. The financial services business in the Company's market areas is highly competitive, and is becoming more so due to technological advances (particularly Internet based financial services delivery), changes in the regulatory environment, and the enormous consolidation which has occurred among financial services providers. Many of the Company's competitors are much larger in total assets and market capitalization, enjoy greater liquidity in their equity securities, have greater access to capital and funding, and offer a broader array of financial products and services. In light of this environment, there can be no assurance that the Company will be able to compete effectively. The results of the Company may materially differ in future periods depending upon the nature or level of competition.

Credit Quality. A significant source of risk arises from the possibility that losses will be sustained because borrowers, guarantors, and related parties may fail to perform in accordance with the terms of their loans. The Company has adopted underwriting and credit monitoring procedures and credit policies, including the establishment and review of the allowance for loan losses, that management believes are appropriate to control this risk by assessing the likelihood of non performance, tracking loan performance, and diversifying the credit portfolio. Such policies and procedures may not, however, prevent unexpected losses that could have a material adverse effect on the Company's financial condition or results of operations. Unexpected losses may arise from a wide variety of specific or systemic factors, many of which are beyond the Company's ability to predict, influence, and control.

California Energy Crisis. The uncertain supply and cost of electricity and natural gas in California present multiple potential impacts upon the California economy and the financial condition of individuals and businesses. Higher energy costs could lead to an economic dislocation, whereby energy intensive businesses leave California. Uncertain energy supplies and costs may also discourage new business development in California, slowing the pace of economic growth. Less robust economic activity and a worsening financial profile by consumers and businesses in California could lead to greater credit quality issues for the Company in addition to slowing the demand for financial products and services. While the State of California government is attempting to address the California energy crisis, the Company cannot predict what, if any, resolution may ultimately be adopted.

Technology Industry and Technological Change. The pace of economic activity, the demand and pay rates for labor, and real estate valuations in many of the Company's primary market areas are impacted by the technology industry. A prolonged slowdown in the technology business would therefore likely have an adverse impact on the Company's financial condition and results of operations. New products and delivery mechanisms being developed as a result of new technologies present the potential for bypassing the historic bank payments settlement process. As such, the Company is exposed to various associated financial risks.

Employee Retention and Recruitment. The historically low unemployment rate experienced in California and nationally over the past several years has combined with the draw of the Silicon Valley area adjacent to the Company's primary market areas to magnify the Company's risk for employee retention and recruitment. In particular, the Company has faced a continuing challenge to attract and retain high caliber professionals with education and experience in technology, finance, and accounting, as these disciplines have been actively pursued by the many technology companies operating within 50 miles of the Company's headquarters. As a local community bank, the Bank is especially dependent upon the skills of its employees to generate business and manage risk.

Other Risks. From time to time, the Company details other risks with respect to its business and financial results in its filings with the Securities and Exchange Commission.

Lending Activities

General. The Company originates a wide variety of loan products. Loans originated by the Company are subject to federal and state law and regulations. Interest rates charged by the Company on loans are affected by the demand for such loans and the supply of money available for lending purposes and the rates offered by competitors. These factors are, in turn, affected by, among other things, economic conditions, monetary policies of the federal government, including the Federal Reserve Board, and legislative tax policies. The Company targets certain lending toward low to moderate income borrowers as part of its commitment to serve its local communities.

At December 31, 2000, the Company's net loan portfolio totaled $391.8 million. This represented the highest total in the Company's history. The vast majority of this portfolio was associated with real estate of various types. Loan credit commitments and purchases in 2000 totaled $169.7 million, down slightly from $173.3 million during 1999. This decrease stemmed in part from a less robust mortgage refinance market in 2000 versus 1999.

Net loans as a percentage of total assets increased from 77.9% at December 31, 1999 to 80.6% at December 31, 2000. Allocating a greater percentage of its total assets to loans is fundamental to the Company's strategy of effectively supporting the financing needs of its local communities.

The mix of loans originated and purchased in 2000 reflected the Company's business strategy of becoming a broader based, community focused financial services firm with a balance sheet diversified away from the Bank's historic concentration in relatively lower yielding residential mortgages. The Company realized particular progress in 2000 in bolstering its production of income property loans, taking advantage of favorable real estate markets in many of the communities served by the Company. The Company also conducted a series of loan participations and purchases with other financial institutions in 2000, particularly for multifamily loans, as a means of both augmenting loan volume and diversifying credit risk.

The Company accepts loan applications generated through brokers for most of its product line. Broker referred loans are underwritten in the same manner as direct originations. The Company encourages its employees to refer and solicit loan business as an integral part of functioning as a community bank. Employees receive various types of awards or commissions based upon the volume and nature of business booked.

The Company requires title and hazard insurance for all real estate loans. More detailed information regarding the Company's lending activity is included in the following paragraphs which present activity by loan product category.

Residential One To Four Unit Mortgage Lending. The Company originates fixed rate, adjustable rate, and hybrid (fixed for a period, and then adjustable) mortgage loans secured by one to four family residential properties. Adjustable rate mortgage loans have interest rates that adjust monthly, semiannually, or annually and reprice based upon various indices, primarily the 11th FHLB District Cost of Funds Index ("COFI") or the US Treasury One Year Constant Maturities Index ("1 Year CMT") . In the Year 2001, the Company intends to commence originating residential mortgages tied to the MTA index, which is equivalent to the twelve month rolling average of the 1 Year CMT index. The MTA index is utilized by a number of the Company's primary competitors and is often preferred by consumers due to its limited volatility relative to the 1 Year CMT index. The Company's hybrid and adjustable rate residential mortgages typically contain various periodic and lifetime rate caps. The Company regularly adjusts its loan products to meet changing customer needs and to respond to the marketplace.

The majority of loan originations are to existing or past customers and members of the Bank's local communities. The Company also originates one to four family residential construction loans for both owner occupants and developers / contractors ("speculative construction loans"). The Company also originates residential mortgages secured by non-owner occupied one to four family properties acquired as an investment by the borrower. The Company provides escrow (impounds) services as requested by its customers and generally for those loans in excess of 80.0% loan to value.

At December 31, 2000, the Company maintained $160.2 million in residential permanent mortgages, representing 40.3% of loans held for investment net of undisbursed loan funds. This compares to $168.5 million in permanent residential mortgages a year earlier, which then constituted 46.3% of loans held for investment net of undisbursed loan funds. This decline in residential mortgage volume and mix was coincident with the Company's business strategy. The Company generally sells its fixed rate residential production into the secondary market on a servicing released basis. These sales are conducted as part of the Company's asset / liability management strategy. The sales are generally on a servicing released basis because the Company believes the servicing is more valuable to high volume, low marginal cost servicers.

From time to time, based on its asset / liability strategy, the Company purchases residential mortgage loans originated by others. In 2001, depending upon loan origination volume and mix, the Company may consider the sale of certain hybrid or adjustable rate residential mortgages into the secondary market.

The majority of the residential loans at December 31, 2000 were secured by properties located within the Company's primary market area, and to a lesser extent the State of California. At December 31, 2000, 11.6% of the Company's one-to-four family mortgage loans had fixed terms and 88.4% had adjustable rates. The Company offers a variety of adjustable rate residential loan products, including an "easy qualifier" loan with more limited documentation required than other mortgages. The Company began originating loans subject to negative amortization in 1996. Negative amortization involves a greater risk to the Company because during a period of high interest rates the loan principal may increase above the amount originally advanced. However, the Company believes that the risk of default on these loans is mitigated somewhat by negative amortization caps, underwriting criteria, relatively low loan to value ratios, and the stability provided by payment schedules. At December 31, 2000, the Company's residential loan portfolio included $33.5 million of loans subject to negative amortization.

The Company originates one to four family residential mortgage loans in amounts up to 80% of the lower of the appraised value or the selling price of the property securing the loan, and up to 97% of the appraised value or selling price if private mortgage insurance is obtained. Mortgage loans originated by the Company generally include due on sale clauses which provide the Company with the contractual right to deem the loan immediately due and payable in the event the borrower transfers ownership of the property without the Company's consent.

Due on sale clauses are an important means of adjusting the rates on the Company's mortgage loan portfolio and the Company has generally exercised its rights under these clauses.

The largest residential loan in the Company's portfolio at December 31, 2000 totaled $3.2 million, secured by a home in Carmel Valley, California. The second largest residential loan at December 31, 2000 was $2.2 million, secured by a home in Monte Sereno, California. The loan to value ratios on these two loans at origination were 50.0% and 70.0%, respectively.

Multifamily Lending. The Company offers hybrid and adjustable rate permanent multifamily (five or more units) real estate loans secured by real property in California. The Company also periodically extends construction financing to builders of multifamily housing. From time to time, the Company extends loans secured by mixed use property in more urban areas, which typically present commercial (often retail) space in one part of the building (often street level) and residential units in other parts of the building.

Multifamily housing valuations have generally increased in California during the past several years, as supply has not expanded with the same speed as population growth, leading to greater demand for units and thus higher market rents.

Permanent loans on multifamily properties typically present maturities of up to 30 years. Factors considered by the Company in reaching a lending decision on such properties include the net operating income of the mortgaged premises before debt service and depreciation, the debt service ratio (the ratio of net earnings to debt service), the ratio of the loan amount to appraised value, and the financial profile of any guarantors. Pursuant to the Company's underwriting policies, multifamily adjustable rate mortgage loans are generally originated in amounts up to 75% of the appraised value of the underlying properties. The Company generally requires a debt service ratio of at least 1.10. Properties securing loans are appraised by an independent appraiser. Title insurance is required on all loans. When evaluating the qualifications of the borrower for a multifamily loan, the Company considers the financial resources and income level of the borrower, the borrower's experience in owning or managing similar property, and the Company's lending experience with the borrower. The Company's underwriting policies require that the borrower provide evidence of ability to repay the mortgage on a timely basis and maintain the property from current rental income. In evaluating the creditworthiness of the borrower, the Company generally reviews the borrower's financial statements, employment, tax returns, and credit history, as well as other related documentation.

Loans secured by apartment buildings and other multifamily residential properties are generally larger and involve a greater degree of risk than one to four family residential loans. Because payments on loans secured by multifamily properties are often dependent on successful operation or management of the properties, repayment of such loans may be subject to a greater extent to adverse conditions in the real estate market or the economy. The Company seeks to minimize these risks through its underwriting policies, which require such loans to be qualified at origination on the basis of the property's income and debt coverage ratio. The Company also attempts to limit its risk exposure by requiring annual operating statements on the properties and by acquiring personal guarantees from the borrowers when available.

As part of its operating strategy, the Company intends to continue increasing its multifamily lending within the State of California. At December 31, 2000, the Company's portfolio of multifamily loans totaled $76.7 million, or

19.3% of loans receivable held for investment less undisbursed loan funds. This compares to $42.2 million, or 11.6% of loans receivable held for investment less undisbursed loan funds, at December 31, 1999. The Company acquired multifamily loans from direct originations, broker referrals, and pool purchases during 2000.

At December 31, 2000, the Company's two largest multifamily loans had outstanding balances of $3.8 million and $2.7 million, respectively. The loans were secured by apartment buildings located in Fresno and Oceanside, California, respectively.

Because the primary marketplace the Company serves has a limited volume of multifamily properties, the Company intends to continue pursuing multifamily real estate loans secured by properties located throughout California. The Company's strategy in this regard includes purchasing participations in multifamily loans originated by experienced, local lenders with a favorable record of quality loan origination. The acquisition and origination of multifamily loans throughout California presents the Company with geographic diversification, but also introduces credit exposure due to the greater demands of monitoring the demand for and value of multifamily real estate in a greater number of local market areas.

Commercial & Industrial Real Estate Lending. The Company originates both permanent and construction loans secured by commercial & industrial real estate located primarily in California. The Company's underwriting procedures provide that commercial & industrial real estate loans may generally be made in amounts up to the lesser of 65% of the appraised value of the property or up to a debt service coverage ratio of 1.20. Permanent loans may be made with terms up to 25 years and are typically hybrid (fixed for three to five years, then adjustable) or adjustable based upon the 1 Year CMT or COFI indices. The Company's underwriting standards and credit review procedures on commercial & industrial real estate loans are similar to those applicable to multifamily loans. The Company considers the property's net operating income, the loan to value ratio, the presence of guarantees, and the borrower's expertise, credit history, and financial status.

The Company's commercial & industrial real estate loans are typically secured by properties such as retail stores, retail strip centers, office buildings, and light manufacturing facilities. The Company typically does not extend loans for the acquisition or refinance of major manufacturing facilities, as that type of real estate generally encompasses larger loans than the Company makes.

The majority of the commercial & industrial real estate loans are secured by property located in Northern and Central California. However, the Company has in the past two years pursued participations on and purchases of commercial & industrial real estate loans with experienced, local lenders in the greater San Diego and Los Angeles markets as a means of increasing loans outstanding and geographically diversifying the Company's loan portfolio.

At December 31, 2000, the Company's permanent commercial & industrial real estate loan portfolio totaled $102.3 million, or 25.8% of loans held for investment net of undisbursed loan funds. This compares to $72.3 million, or 19.9% of loans held for investment net of undisbursed loan funds, at December 31, 1999. This nominal and relative expansion is consistent with the Company's business strategy of increasing the percentage of its balance sheet represented by income property loans, with an offsetting proportional reduction in residential mortgages.

At December 31, 2000, the Company had outstanding twenty-one loans totaling $31.8 million secured by hotels / motels, one of which was a construction loan. The largest such loan is a permanent loan with $5.0 million outstanding secured by a nationally branded hotel located in Dublin, California. The next largest hotel / motel loan at December 31, 2000 was for $2.8 million for a property in Aptos, California, in the center of the Company's primary market area.

At December 31, 2000, the Company had outstanding five loans to mini-storage facilities totaling $7.3 million, two of which were construction loans and the largest of which was a permanent loan for $2.6 million secured by a mini-storage facility in Santa Cruz, California.

The largest permanent commercial real estate loan in the Company's portfolio at December 31, 2000 not mentioned above was $3.8 million, secured by a church and related facilities located in San Jose, California.

Loans secured by commercial & industrial real estate properties, like multifamily loans, are generally larger and involve a greater degree of risk than one to four family residential mortgage loans. Because payments on loans secured by commercial real estate properties are often dependent on successful operation or management of the properties, repayment of such loans may be significantly subject to adverse conditions in the properties' management or real estate markets in general or particular to a subject property. The Company seeks to mitigate these risks through its underwriting standards and credit review policy, which requires annual operating statements for each collateral property. The Company also participates larger commercial & industrial real estate loans with other financial institutions as a means of diversifying its credit risk and remaining below the Bank's regulatory limit on loans to one borrower.

Commercial & industrial real estate loans can present various environmental risks, as such properties are sometimes located on sites or in areas where various types of pollution may have historically occurred. The Company attempts to mitigate this risk via environmental surveys, reports, and, in some cases, testing; in addition to using a limited list of pre-approved appraisers. In addition, Company lending staff directly inspect most commercial & industrial real estate properties on which the Company lends. Commercial & industrial real estate can also be impacted by changing government regulation.

Construction Lending. The Company originates construction loans for the acquisition and development of property. Collateral has been historically concentrated in residential properties, both owner occupied and speculative, as well as commercial real estate, including both retail properties and warehouse / storage facilities.

Construction financing is generally considered to involve a higher degree of risk than long-term financing on improved, occupied real estate. The Company's risk of loss on construction loans depends largely upon the accuracy of the initial estimate of the property's value at completion of construction or development and the estimated cost (including interest) of construction. If the estimate of construction costs proves to be inaccurate, the Company may have to advance funds beyond the amount originally committed to permit completion of the development and to protect its security position. The Company may also be confronted, at or prior to maturity of the loan, with a project with insufficient value to ensure full repayment. The Company's underwriting, monitoring, and disbursement practices with respect to construction financing are intended to ensure that sufficient funds are available to complete construction projects. The Company attempts to limit its risk through its underwriting procedures, by using only approved, qualified appraisers, and by dealing with qualified builders / borrowers. The Company also participates larger construction loans with other financial institutions as a means of diversifying its credit risk and remaining below the Bank's regulatory limit on loans to one borrower.

The Company's construction loans typically have adjustable rates and terms of 12 to 18 months. The Company originates one to four family and multifamily residential construction loans in amounts up to 80% of the appraised value of the property. Land development loans are determined on an individual basis, but in general they do not exceed 70% of the actual cost or current appraised value of the property, whichever is less. Loan proceeds are disbursed in increments as construction progresses and as inspections warrant.

At December 31, 2000, the Company had gross construction and land development loans totaling $59.1 million, on which there were undisbursed loan funds of $26.6 million. The net outstanding balance of $32.5 million represented 8.2% of loans held for investment net of undisbursed loan funds at December 31, 2000. At December 31, 1999, the Company had gross construction and land development loans totaling $79.0 million, on which there were undisbursed loan funds of $23.9 million. The net outstanding balance of $55.2 million represented 15.1% of loans held for investment net of undisbursed loan funds at December 31, 1999.

The decline in construction loans during 2000 resulted from payoffs from completed projects not being replaced by an adequate inflow of new business. In general, the Company's strategy is, however, to increase the construction loan portfolio and to have construction loans represent a greater portion of total assets. The Company has targeted increased construction lending because of the interest rate sensitivity of the loans, the Company's historic expertise and experience in this type of lending, the yields available from this type of lending, and, in the case of owner residential construction loans, the strong customer bond developed in financing the building of someone's home.

The largest construction credit in the Company's portfolio at December 31, 2000 was a $2.85 million gross commitment to fund the construction of a recreational vehicle park in Gilroy, California. The second largest construction loan maintained by the Company at December 31, 2000 was a gross commitment of $2.45 million associated with the construction and development of a mini-storage facility in San Jose, California. The Company's construction loans are largely concentrated in the Company's primary marketplaces, although a limited amount of construction lending has occurred throughout Northern California.

Because construction loans are generally larger and more complex than typical residential mortgages, they present a greater degree of credit risk. The Company attempts to control this credit risk through its underwriting and funds disbursement processes. In addition, it is the Company's strategy to, over time, build a series of strong relationships with local developers / builders / contractors with whom the Company has detailed financial knowledge and receives a steady stream of repeat business.

Land Lending. The Company offers loans secured by land, generally located in its immediate marketplace. The types of land generally considered by the Company are suitable for residential development or are demarcated residential lots. The Company does not extend loans on agricultural land where repayment of the loan is dependent upon crop sales.

At December 31, 2000, the Company had land loans totaling $16.3 million, or 4.1% of gross loans held for investment net of undisbursed loan funds. This compares to land loans totaling $13.9 million, or 3.8% of gross loans held for investment net of undisbursed loan funds at December 31, 1999. The largest land loan in the Company's portfolio at year-end 2000 was a $2.8 million credit secured by land targeted for future residential development located in Los Altos, California. The Company's second largest land loan at December 31, 2000 was $1.7 million, secured by commercially zoned land located in Monterey, California. The Company's third largest land loan at December 31, 2000 was $1.2 million, secured by land included within a large, upscale residential development located in Monterey, California.

Because land and lots are generally less readily marketable than residential real estate, lending on land presents additional risks not present in residential mortgages. The market value of land and lots can be more susceptible to changes in interest rates, economic conditions, or local real estate markets than the market value for homes. Zoning changes by various government authorities may also impact the value and marketability of certain types of land. To mitigate these risks, the Company generally restricts land and lot loans to its primary local market areas, where the Company has the most thorough understanding of land values and trends in the demand for land.

Business Lending. The Company offers business loans primarily collateralized by business assets. Such collateral is typically comprised of accounts receivable, inventory, and equipment. Business lending is generally considered to involve a higher degree of risk than the financing of real estate, primarily because security interests in the collateral are more difficult to perfect and the collateral may be difficult to obtain or liquidate following an uncured default. Business loans typically offer relatively higher yields, short maturities, and variable interest rates. The availability of such loans enables existing and potential business depositors to establish a more complete financial relationship with the Bank. The Company attempts to reduce the risk of loss associated with business lending by closely monitoring the financial condition and performance of its customers.

As part of its business strategy, and in order to facilitate the growth of its business lending portfolio, the Company plans in 2001 on having substantially every business loan managed by an assigned account manager, who is a commercial banker. The Company believes this approach provides for better credit monitoring and facilitates the Company's seeking expanded business relationships with growing firms. The Company's business strategy envisions business loans representing a greater percentage of total assets in the future.

During 1999, the Company introduced its "Business Express" lending program, whereby small businesses may obtain lines of credit of up to $25,000 with a relatively brief application and limited supporting documentation, augmented by a quick credit decision on the part of the Bank. This program was implemented to strengthen the Company's relationship with the small businesses in the Company's primary market areas, many of whom have been deposit customers for some period of time. The Company continued to support this program during 2000.

At December 31, 2000, the Company had business term loans totaling $1.6 million and drawn balances against business lines of credit totaling $1.4 million. In the aggregate, business loans comprised 0.8% of gross loans held for investment net of undisbursed loan funds at December 31, 2000. The business loan with the largest outstanding balance in the Company's portfolio at December 31, 2000 was a $261 thousand term loan to a retail store in Aptos, California. At December 31, 2000, the Company had extended two business lines of credit for $500 thousand each. These lines were extended to a wholesale distributor of food products and a law firm. Both of these customers' operations were in Santa Cruz County.

Loan Approval Procedures And Authority. The Board of Directors has ultimate responsibility for the lending activity of the Company and establishes the lending policies of the Company, including the appraisal policy and credit approval authorities. The Board of Directors also approves all appraisers used by the Company. As of December 31, 2000, the Board of Directors has authorized the following loan approval authorities:

Real Estate Loans

(1) Residential mortgage loans in amounts up to the federal agency (e.g. Federal National Mortgage Association or "FNMA") conforming limit may be approved by the Company's staff underwriters.

(2) Loans in excess of the agency conforming limits and up to $500,000 may be approved by the underwriting / processing manager.

(3) Loans in excess of $500,000 and up to $750,000 may be approved by the real estate loan administrator.

(4) Loans in excess of $750,000 and up to $1,000,000 require the approval of the Chief Executive Officer / President, Chief Loan Officer, or the Director of Commercial Banking.

(5) Loans in excess of $1,000,000 and up to $2,000,000 require the approval of two of the Chief Executive Officer / President, Chief Loan Officer, or Director of Commercial Banking.

(6) Loans in excess of $2,000,000 and up to $4,000,000 require the approval of the Board of Directors Loan Committee.

(7) Loans greater than $4,000,000 must be approved by the full Board of Directors.

Non-Real Estate Loans

(1) "Business Express" loans of up to $25,000 require the approval of the real estate loan administrator, a professional banker, or a business development officer.

(2) Overdraft lines of credit of up to $1,500 require the approval of the underwriting / processing manager or the real estate loan administrator.

(3) Loans of up to $75,000 require the approval of the Chief Loan Officer.

(4) Loans in excess of $75,000 and up to $250,000 require the approval of the Chief Executive Officer or Director of Commercial Banking.

(5) Loans in excess of $250,000 and up to $2,000,000 require the approval of the Board of Directors Loan Committee.

(6) Loans in excess of $2,000,000 must be approved by the full Board of Directors.

The loan origination process requires that upon receipt of a completed loan application, a credit report is obtained and certain information is verified. If necessary, additional financial information is obtained from the prospective borrower. An appraisal of the related real estate is performed by an independent, licensed appraiser. If the original loan exceeds 80% loan to value on a first trust deed loan or private mortgage insurance is required, the borrower is required to make payments to a loan impound account from which the Company makes disbursements for property taxes and insurance.

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Loan Portfolio Composition. The following table presents the composition of the Company's net loans receivable held for investment at the dates indicated.

	At December 31,						
	2000		1999		1998		
	Amount	%	Amount	%	Amount	%	Amount
				(Dollars In Thousands)			
Loans secured by real estate							
Residential one to four unit	$160,155	37.8%	$168,465	43.4%	$181,771	55.8%	$201,562
Multifamily five or more units	76,727	18.1%	42,173	10.9%	33,340	10.2%	23,355
Commercial and industrial	102,322	24.1%	72,344	18.6%	39,997	12.3%	20,159
Construction	59,052	13.9%	79,034	20.3%	51,624	15.9%	35,150
Land	16,310	3.9%	13,930	3.6%	7,774	2.4%	1,869
Sub-total loans secured by real estate	414,566	97.8%	375,946	96.8%	314,506	96.6%	282,095
Other loans							
Home equity lines of credit	5,631	1.3%	3,968	1.0%	3,262	1.0%	3,142
Other consumer loans	669	0.2%	587	0.2%	658	0.2%	598
Business term loans	1,641	0.4%	6,670	1.7%	6,679	2.0%	943
Business lines of credit	1,438	0.3%	1,027	0.3%	595	0.2%	270
Sub-total other loans	9,379	2.2%	12,252	3.2%	11,193	3.4%	4,953
Total gross loans	423,945	100.0%	388,198	100.0%	325,699	100.0%	287,048
(Less) / Plus							
Undisbursed loan funds	(26,580)		(23,863)		(24,201)		(21,442
Unamortized premiums & discounts	21		134		491		556

Deferred loan fees, net	(202)	(281)	(434)	(742
Allowance for loan losses	(5,364)	(3,502)	(2,780)	(1,669
Total loans held for investment, net	$391,820	$360,686	$298,775	$263,751

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Loan Maturity Profile. The following table shows the contractual maturities of the Company's gross loans at December 31, 2000.

	At December 31, 2000			
	2001	2002 Through 2005	2006 And Thereafter	Total Gross Loans
	(Dollars In Thousands)			
Residential one to four unit	$ 2	$ 596	$159,557	$160,155
Multifamily five or more units	63	274	76,390	76,727
Commercial and industrial real estate	364	9,402	92,556	102,322
Construction	46,674	12,378	--	59,052
Land	8,613	6,479	1,218	16,310
Home equity lines of credit	114	1,266	4,251	5,631
Other consumer loans	652	17	--	669
Business term loans	--	1,243	398	1,641
Business lines of credit	1,434	4	--	1,438
Total	$ 57,916	$ 31,659	$334,370	$423,945

The following table presents the Company's gross loans at December 31, 2000, segregating those with fixed versus adjustable interest rates and also isolating those loans with contractual maturities less than or equal to and greater than one year.

	Matures In 2001		Matures After 2001		Total	
	Fixed	Adjustable	Fixed	Adjustable	Fixed	A
	(Dollars In Thousands)					
Residential one to four unit	$ 2	$ --	$ 18,504	$141,649	$ 18,506	
Multifamily five or more units	63	--	933	75,731	996	
Commercial and industrial real estate	--	364	7,500	94,458	7,500	
Construction	11,886	34,788	331	12,047	12,217	
Land	--	8,613	--	7,697	--	
Home equity lines of credit	--	114	--	5,517	--	
Other consumer loans	652	--	17	--	669	

Business term loans	--	--	--	1,641	--
Business lines of credit	--	1,434	--	4	--
Total	$ 12,603	$ 45,313	$ 27,285	$338,744	$ 39,888
Percent of gross loans outstanding	3.0%	10.7%	6.4%	79.9%	9.4%

Originations, Purchases, and Sales of Loans. The Company's mortgage lending activities are conducted primarily through its eight branch offices and approximately 60 wholesale loan brokers who deliver completed loan applications to the Company. In addition, the Company has developed correspondent relationships with a number of financial institutions to facilitate the origination of real estate loans on a participation basis. Loans presented to the Company for purchase or participation are generally underwritten substantially in accordance with the Company's established lending standards, which consider the financial condition of the borrower, the location of the underlying property, and the appraised value of the property, among other factors.

The Company plans to continue actively purchasing individual loans, loan pools, and loan participations in 2001 as a means of utilizing the Bank's strong regulatory capital position and supporting the more rapid transformation of the Company's balance sheet into that more consistent with a California community commercial bank.

On an ongoing basis, depending on its asset / liability strategy, the Company originates one to four family residential loans for sale in the secondary market. Loan sales are dependent on the level of loan originations and the relative customer demand for mortgage loans, which is affected by the current and expected future level of interest rates. During the years ended December 31, 2000 and 1999, the Company sold $2.7 million and $8.9 million, respectively, of fixed rate residential loans. The Company generally sells its fixed rate residential loans on a servicing released basis in order to take advantage of comparatively attractive servicing premiums being offered in the secondary market. The level and timing of any future loan sales will depend upon market opportunities and prevailing interest rates.

From time to time, depending on its asset / liability strategy, the Company converts a portion of its mortgages into readily marketable mortgage backed securities. In 1998, the Company converted approximately $48.4 million of fixed rate residential loans into mortgage backed securities. The securitization was undertaken primarily to provide greater liquidity for the assets and thereby augment the Company's ability to manage its interest rate risk profile and cash flows. There was no similar securitization activity in 2000 or 1999. The Company may pursue additional securitizations and / or the sale of hybrid or adjustable rate residential mortgages, depending upon its asset / liability management strategy, in the future.

Loan Servicing. The Company services its own loans as well as loans owned by others. Loan servicing includes collecting and remitting loan payments, accounting for principal and interest, holding escrow funds for the payment of real estate taxes and insurance premiums, contacting delinquent borrowers, and supervising foreclosures and property dispositions in the event of unremedied defaults. Loan servicing income includes servicing fees from investors and certain charges collected from borrowers, such as late payment fees. At December

31, 2000, the Company was servicing $62.0 million of loans for others.

The Company's strategic plan does not contain a significant expansion in its loan servicing for others, as management believes large volume residential loan servicers enjoy economies of scale and efficiencies in this business that render it difficult for the Company to compete and generate a desirable rate of return. The significant consolidation in the residential loan servicing industry that has occurred over the past several years, in the opinion of management, supports this position.

Credit Quality

General. Although management believes that non-performing loans are generally well secured and / or reserved, real estate acquired through foreclosure is properly valued, and inherent losses are provided for in the allowance for loan losses, there can be no assurance that future deterioration in local or national economic conditions, collateral values, borrowers' financial status, or other factors will not result in future credit losses and associated charges against operations. In regards to real estate acquired via foreclosure, although all such properties are actively marketed by the Company, no assurance can be provided regarding when these properties will be sold or what the terms of sale will be when they are sold. It is the Company's general policy to obtain appraisals at the time of foreclosure and to periodically obtain updated appraisals for foreclosed properties that remain unsold.

Non-accrual, Delinquent, And Restructured Loans. Management generally places loans on non-accrual status when they become 90 days past due, unless they are well secured and in the process of collection. Management also places loans on non-accrual status when they are less than 90 days delinquent when there is concern about the collection of the debt in accordance with the terms of the loan agreement. When a loan is placed on non-accrual status, any interest previously accrued but not collected is reversed from income. Loans are charged off when management determines that collection has become unlikely. Restructured loans are those where the Company has granted a concession on the interest paid or the original repayment terms due to financial difficulties of the borrower or because of issues with the collateral securing the loan.

Delinquent Loan Procedures. Specific delinquency procedures vary depending on the loan type and period of delinquency. However, the Company's policies generally provide that loans be reviewed monthly for delinquencies, and that if a borrower fails to make a required payment when due, the Company institutes internal collection procedures. For mortgage loans, written late charge notices are mailed no later than the 15th day of delinquency. At 25 days past due, the borrower is contacted by telephone and the Company makes a verbal request for payment. At 30 days past due, the Company begins tracking the loan as a delinquency, and at 45 days past due a notice of intent to foreclose is mailed. When contact is made with the borrower prior to foreclosure, the Company generally attempts to obtain full payment or develop a repayment schedule with the borrower to avoid foreclosure.

Non-performing Assets. Non-performing loans include non-accrual loans, loans 90 or more days past due and still accruing interest, and restructured loans. Non-performing assets include all non-performing loans, real estate acquired via foreclosure, and repossessed consumer assets.

Real estate acquired via foreclosure is recorded at the lower of the recorded investment in the loan or the fair value of the related asset on the date of foreclosure, less estimated costs to sell. Fair value is defined as the amount in cash or cash-equivalent value of other consideration that a real estate asset would yield in a current sale between a willing buyer and a willing seller. Development and improvement costs relating to the property are capitalized to the extent they are deemed to be recoverable upon disposal. The carrying value of acquired property is regularly evaluated and, if appropriate, an allowance is established to reduce the carrying value to fair value less estimated costs to sell. The Company typically obtains appraisals on real estate acquired through foreclosure at the time of foreclosure. The Company generally conducts inspections on foreclosed properties and properties deemed in-substance foreclosures on a quarterly basis.

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The following table presents information regarding non-performing assets at the dates indicated.

	At December		
	2000	1999	1998
	(Dollars In Tho		
Outstanding Balances Before Valuation Reserves			
Non-accrual loans	$4,666	$6,888	$1,478
Loans 90 or more days delinquent and accruing interest	--	--	--
Restructured loans in compliance with modified terms	75	1,294	1,437
Total gross non-performing loans	4,741	8,182	2,915
Investment in foreclosed real estate before valuation reserves	--	96	322
Repossessed consumer assets	--	--	--
Total gross non-performing assets	$4,741	$8,278	$3,237
Gross non-performing loans to total loans	1.19%	2.25%	0.96%
Gross non-performing assets to total assets	0.98%	1.79%	0.71%
Allowance for loan losses	$5,364	$3,502	$2,780
Allowance for loan losses / non-performing loans	113.14%	42.80%	95.37%
Valuation allowances for foreclosed real estate	$ --	$ --	$ 41

The decrease in non-accrual loans during 2000 was primarily due to the repayment in full of a single $5.0 million business term loan that was on non-accrual status at December 31, 1999, partially offset by a $2.85 million commercial construction loan being placed on non-accrual status during 2000. The decline in restructured loans during 2000 primarily resulted from a number of residential loans that had been impacted by the bankruptcy filing of the borrower no longer being classified as troubled debt restructurings due to the payment performance of the borrower over an extended period of time and the continued maintenance and receipt of market terms by the Company.

The following table presents information concerning loans 60 to 89 days delinquent at the dates indicated.

Loans On Accrual Status And Delinquent 60 - 89 Day

(Dollars In Thousands)	2000 Number Of Loans	2000 Principal Balance	1999 Number Of Loans	1999 Principal Balance
Residential one to four unit	4	$ 857	2	$ 285
Land	--	--	--	--
Other consumer loans	--	--	--	--
Total	4	$ 857	2	$ 285
Delinquent loans to gross loans net of undisbursed loan funds		0.22%		0.08%

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The following table presents information regarding non-accrual loans at the dates indicated.

	Loans On Non-accrual Status At Decembe			
(Dollars In Thousands)	2000 Number Of Loans	2000 Principal Balance	1999 Number Of Loans	1999 Principal Balance
Residential one to four unit	2	$ 603	4	$ 543
Commercial and industrial real estate	2	1,133	2	1,146
Commercial construction	1	2,852	--	--
Business term loans	3	78	1	5,000
Business lines of credit	--	--	2	199
Total	8	$ 4,666	9	$ 6,888
Non-accrual loans to gross loans net of undisbursed loan funds		1.17%		1.89%

Interest income foregone on non-accrual loans outstanding at year-end totaled $110 thousand, $109 thousand, and $76 thousand for the years ended December 31, 2000, 1999, and 1998, respectively. During early 2001, the separate collateral securing the non-accrual commercial construction loan and one of the non-accrual commercial and industrial real estate loans at December 31, 2000 was in escrow for sale. The Company cannot predict, however, whether such escrows will close. At December 31, 2000, the Company was in the process of foreclosing on both of the subject properties.

The following table presents information concerning restructured loans that were on accrual status at the dates indicated.

(Dollars In Thousands)	Troubled Debt Restructured Loans On Accrual Status			
	2000		1999	
	Number Of Loans	Principal Balance	Number Of Loans	Principal Balance
Residential one to four unit	1	$ 75	8	$ 1,294
Multifamily five or more units	--	--	--	--
Total	1	$ 75	8	$ 1,294

The following table presents additional information concerning loans classified as troubled debt restructurings:

(Dollars In Thouands, Numbers In Whole Units)	At December 2000	1999
Troubled debt restructurings performing per terms:		
Number of loans	1	8
Principal balance outstanding	$ 75	$ 1,294
Weighted average interest rate	8.95%	7.60%
Troubled debt restructurings not performing per terms:		
Number of loans	1	1
Principal balance outstanding	$ 294	$ 119
Weighted average interest rate	8.50%	7.00%
Total troubled debt restructurings:		
Number of loans	2	9
Principal balance outstanding	$ 369	$ 1,413
Weighted average interest rate	8.60%	7.55%

Criticized And Classified Assets. To measure the quality of assets, the Company has established internal asset classification guidelines as part of its credit monitoring system for identifying and reporting current and potential problem assets. Under these guidelines, both asset specific and general portfolio valuation allowances are established.

The Company currently classifies problem and potential problem assets into one of four categories, presented below in order of increasing severity.

Category	Definition

Criticized Assets

Special Mention	Special Mention loans (sometimes referred to as "watch list" loans) possess weaknesses, but do not currently expose the Company to sufficient risk to warrant categorization as a classified asset or assignment of a specific valuation allowance. Weaknesses that might categorize a loan as Special Mention include, but are not limited to, past delinquencies or a general decline in business, real estate, or economic conditions applicable to the loan.

Classified Assets

Substandard	Substandard loans have one or more defined weakness and are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.
Doubtful	Doubtful loans have the weaknesses of substandard loans, with the additional characteristic that the weaknesses make collection or liquidation in full on the basis of currently existing facts, conditions, and values questionable; and there is a high possibility of loss of some portion of the principal balance.
Loss	Loss loans are considered uncollectible and their continuance as an asset is not warranted.

Assets classified as substandard or doubtful require the establishment of general valuation allowances in amounts considered by management to be adequate under generally accepted accounting principles. These amounts represent loss allowances which have been established to recognize the inherent risk associated with lending activities, but which, unlike specific allowances, have not been allocated to particular problem assets. Judgments regarding the adequacy of general valuation allowances are based on continual evaluation of the nature, volume and quality of the loan portfolio, other assets, and current economic conditions that may affect the recoverability of recorded amounts. Assets classified as a loss require either a specific valuation allowance equal to 100% of the amount classified or a charge-off of such amount.

The following table presents the Company's criticized and classified assets at the dates indicated:

	At
Outstanding Balances Before Specific Valuation Allowances	2000
	(Dolla

Criticized Assets	
Special mention	$2,283
	======
Classified Assets	
Substandard loans	$6,923
Real estate acquired via foreclosure	--

Total classified assets	$6,923
	======
Classified assets to total loans plus other real estate owned (1)	1.74%
Classified assets to total assets	1.42%
Classified assets to shareholders' equity	15.79%
Allowance for loan losses to total classified assets	77.48%

A savings institution's determination as to the classification of its assets and the amount of its valuation allowances is subject to review by the OTS, which can require the establishment of additional general or specific loss allowances. The OTS, in conjunction with the other federal banking agencies, has adopted an interagency policy statement on allowances for loan and lease losses which provides guidance in determining the adequacy of general valuation guidelines. The policy statement recommends that savings institutions establish effective systems and controls to identify, monitor, and address asset quality problems, analyze significant factors that affect the collectibility of assets, and establish prudent allowance evaluation processes. Management believes that the Company's allowance for loan losses is adequate given the composition and risks of the loan portfolio. However, actual losses are dependent upon future events and, as such, further additions to the level of specific and general loan loss allowances may become necessary. In addition, there can be no assurance that at some time in the future the OTS, in reviewing the Company's loan portfolio, will not request the Company to increase its allowance for loan losses, thus negatively impacting the Company's results of operations for that time period.

Impaired Loans. The Company defines a loan as impaired when it meets one or more of the following criteria:

- It is probable that the Company will be unable to collect all contractual principal and interest in accordance with the original terms of the loan agreement.

- The loan is ninety or more days past due.

- The loan is placed on non-accrual status although less than ninety days past due.

- A specific valuation reserve has been allocated against the loan.

- The loan meets the criteria for a troubled debt restructuring.

The policy of the Company is to review each loan in the portfolio to identify problem credits. The nature of this review varies by the type of loan and its underlying collateral. For example, most residential mortgages are evaluated for impairment following a delinquency, while the Company conducts credit analysis on each income property loan exceeding certain thresholds at least annually regardless of payment performance. In reviewing each loan, the Company evaluates both the amount the Company believes is probable that it will collect and the timing of such collection. As part of the loan review process, the Company considers such factors as the ability of the borrower to continue meeting the debt service requirements, assessments of other sources of repayment, and the fair value of any collateral. Insignificant delays or shortfalls in payment amounts, in the absence of other facts and circumstances, would not alone lead to the conclusion that a loan is impaired.

Each loan identified as impaired is evaluated for the need for a specific loss reserve. The adequacy of these specific loss reserves is reviewed regularly, and no less frequently than quarterly. A loan's specific loss reserve is calculated by comparing the Company's net investment in the loan to one or more of the following, as applicable to the nature of the loan:

- the present value of the loan's expected future cash flows discounted at the loan's effective interest rate at the date of initial impairment

- the loan's observable market price

- the fair value of the collateral securing the loan

The Company charges off a portion of an impaired loan against the specific valuation allowance when it is probable that a part of the loan will not be recoverable.

At December 31, 2000, the Company had impaired loans totaling $5.3 million, which have related specific reserves of $600 thousand. At December 31, 1999, the Company had impaired loans of $8.2 million, with related specific reserves of $200 thousand. Of the $5.3 million in impaired loans at December 31, 2000, $677 thousand were on accrual status due to continued payment performance by the borrowers. Additional information concerning impaired loans is presented below and in Note 5 to the Consolidated Financial Statements.

	2000	1999
		(Dollars In
Average investment in impaired loans for the year	$ 7,790	$ 2,511
Interest recognized on impaired loans at December 31	$ 461	$ 590
Interest not recognized on impaired loans at December 31	$ 110	$ 109

The increase in the average investment in impaired loans in 2000 versus 1999 resulted from a $5.0 million business term loan originated by MBBC that was identified as impaired in the fourth quarter of 1999 and paid off in full in December, 2000.

Other than those loans already categorized as non-performing or classified at December 31, 2000, the Company has not identified any other potential problem loans, which would result in those loans being included as non-performing or classified loans at a future date.

The Company had no loans outstanding to foreign entities at December 31, 2000.

Special Residential Loan Pool. During 1998, the Bank purchased a $40.0 million residential mortgage pool comprised of loans that presented a borrower credit profile and / or a loan to value ratio outside of (less favorable than) the Bank's normal underwriting criteria. To mitigate its credit risk for this portfolio, concurrent with the purchase, the Bank obtained a scheduled principal / scheduled interest loan servicing agreement from the seller. Further, this agreement also contains a guaranty by the seller to absorb any principal losses on the portfolio in exchange for the seller's retention of a portion of the loans' yield through loan servicing fees. In obtaining these credit enhancements, the Bank functionally aggregated the credit risk for this loan pool into a single borrower credit risk to the seller / servicer of the loans. The Bank was subsequently informed by the OTS that structuring the purchase in this manner made the transaction an "extension of credit" by the Bank to the seller / servicer, which, by virtue of its size, violated the OTS' "Loans To One Borrower" regulation. See "Regulation And Supervision - Loans To One Borrower Limitation" and Note 15 to the Consolidated Financial Statements.

At December 31, 2000, the outstanding principal balance of the Special Residential Loan Pool was $16.5 million, with an additional $3.2 million in December payoffs received from the seller / servicer in January, 2001. In comparison, the outstanding principal balance of the Special Residential Loan Pool was $35.0 million at December 31, 1999, with $1.2 million in December 1999 payoffs received from the seller / servicer in January, 2000.

While the seller / servicer met all its contractual obligations through January 20, 2001, the Company has allocated certain general loan loss reserves due to concerns regarding the potential losses by the seller / servicer in honoring the guaranty, the present delinquency profile of the special residential mortgage pool, and the differential between loan principal balances and current appraisals for foreclosed loans and loans in the process of foreclosure.

Because the seller / servicer provides scheduled principal and interest payments regardless of the actual payment performance of the loans and because the seller / servicer absorbs all losses on the disposition of associated foreclosed real estate, the Company reports all loans within the Special Residential Loan Pool as performing.

By December 31, 2000, all of the loans in the Special Residential Loan Pool converted from an initial fixed rate that was maintained for the first two years of the loan to an adjustable rate significantly above current market rates for medium to high credit quality residential mortgages. The weighted average gross interest rate on the Special Residential Loan Pool at December 31, 2000 was 11.44%. The differential between the interest rates on the loans and available refinance rates contributed to the significant prepayments during 2000.

Management believes additional prepayments are likely to occur in 2001. However, management also believes that there will be some loans that will not refinance in the next year due to a lack of available financing for less creditworthy borrowers or because of borrower inaction. By the end of 2001, the Company may therefore be particularly dependent upon the financial strength and continued performance of the seller / servicer, as the remaining portfolio is expected to be comprised of relatively less creditworthy loans while at the same time having a smaller remaining total principal balance and thereby providing less periodic cash flow to the seller / servicer via the retained servicing spread.

In conjunction with this Special Residential Loan Pool, on March 6, 2000, the Bank received a letter from the OTS mandating that the Bank (i) assign all of the loans in the pool a 100% risk based capital weighting, and (ii) not permit its regulatory capital ratios to decline below the levels existing at December 31, 1999. Management does not foresee any compliance issue with this request given:

- o the Bank's regulatory capital position at December 31, 2000
- o remaining a "well capitalized" financial institution is integral to the Bank's business strategy
- o the expected continued generation of regulatory capital expected through retained earnings, the amortization of deferred stock compensation, and the amortization of intangible assets.

Management cannot forecast whether the OTS will impose additional requirements or restrictions as a result of the Special Residential Loan Pool. Management also cannot forecast when the OTS might lift the existing additional requirements. The Bank continues to report to the OTS regarding the Special Residential Loan Pool on a monthly basis.

The Company monitors the financial performance and condition of the seller / servicer on a monthly basis. In addition, the Company regularly analyzes the payment performance and credit profile of the remaining outstanding loans. Portfolio statistics as of the January 20, 2001 remittance for activity through December 31, 2000 include the following:

(Dollars In Thousands)

Category	Number Of Loans	Company Outstanding Investment In Loans
Customer paying per note terms	72	$ 9,110
Customer 30 days delinquent	11	1,390
Customer 60 days delinquent	8	1,156
Customer 90 days or more delinquent	10	991
Foreclosed	3	663
Total	104	$ 13,310

The loans presented as delinquent or foreclosed in the above table are not reported as delinquent, non-accrual, impaired, or foreclosed by the Company, as the seller / servicer has advanced scheduled interest and scheduled principal payments on the loans and thus maintained them all on a current status with the Company.

Additional portfolio statistics as of the January 20, 2001 remittance for activity through December 31, 2000 include the information presented in the following table. FICO Score is a mathematical calculation used throughout the mortgage banking industry that incorporates various variables in quantifying a borrower's credit strength. A higher FICO Score is associated with a borrower who presents a stronger credit profile; e.g. few or no late payments on existing or historical debt, regular employment history, favorable financial profile, etc. A lower FICO Score is associated with a borrower who presents a weaker credit profile; e.g. multiple late payments, uncollected debt, open judgements against the borrower, etc. Various statistical studies in the mortgage banking industry have shown that credit losses typically increase exponentially as FICO

Scores decline. In other words, the incremental default rate expected for a change from a 550 FICO Score to a 500 FICO Score is much larger than the incremental default rate expected for a change from a 750 FICO Score to a 700 FICO Score. According to an article that was posted on the Fair, Isaac, and Company Internet site (Fair Isaac is an industry leader in credit scoring), most mortgage bankers view a FICO Score of 640 or more as allowing the average borrower to obtain a home loan. In early 2001, the OTS published its position that a FICO Score of 660 or below may represent a subprime borrower. Actual results may vary on a case by case basis.

The FICO Scores utilized in the following table are the original FICO Scores for the borrowers which were calculated in 1998 by the seller / servicer of the Special Residential Loan Pool. Borrower credit profiles could have changed, favorably or unfavorably, since that time. The information in the following table is as of the January 20, 2001 remittance for activity through December 31, 2000.

(Dollars In Thousands) Original FICO Score Range	Number Of Loans	Company Outstanding Investment In Loans
Less than 500	2	$ 287
500 through 549	15	1,856
550 through 599	35	4,246
600 through 649	34	4,902
650 through 699	14	1,600
700 through 749	1	67
Above 749	3	352
Total	104	$ 13,310

The weighted average original FICO score for the Special Residential Loan Pool as of the January 20, 2001 remittance for activity through December 31, 2000 was 600.

The original loan to value distribution of the homes securing the loans within the Special Residential Loan Pool as of the January 20, 2001 remittance for activity through December 31, 2000 was as presented in the following table. The original loan to value ratios were determined through an appraisal process undertaken by the seller / servicer of the Special Residential Loan Pool prior to the funding of the loans to the borrowers.

(Dollars In Thousands) Original Loan To Value Range	Number Of Loans	Company Outstanding Investment In Loans
70.0% or less	13	$ 1,332
70.1% through 75.0%	15	1,905
75.1% through 80.0%	34	4,722
80.1% through 85.0%	23	3,078
85.1% through 90.0%	19	2,773
Total	104	$ 13,310

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The weighted average original loan to value ratio for the Special Residential Loan Pool as of the January 20, 2001 remittance for activity through December 31, 2000 was 79.5%. Original loan to value ratios for individual loans ranged from 26% to 90%. However, based upon current appraisals for foreclosed properties and properties in the process of foreclosure within the Special Residential Loan Pool, the Company has become aware of deficiencies in the current market value of certain collateral versus the associated loan balances.

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The geographic distribution of the homes securing the loans within the Special Residential Loan Pool as of the January 20, 2001 remittance for activity through December 31, 2000 was as follows.

(Dollars In Thousands) Collateral Location	Number Of Loans	Company Outstanding Investment In Loans
California	31	$ 4,801
Utah	17	2,286
Oregon	11	1,394
Michigan	8	934
Arizona	8	796
North Carolina	4	540
Missouri	4	500
Indiana	4	274
Colorado	3	396
Washington (state)	3	381
Ohio	3	244
Other	8	764
Total	104	$ 13,310

Allowance For Loan Losses. The allowance for loan losses is established through a provision for loan losses based on management's evaluation of the risks inherent in the Company's loan portfolio. The allowance for loan losses is increased by provisions charged against earnings and reduced by net loan charge-offs. Loans are charged-off when they are deemed to be uncollectible; recoveries are generally recorded only when cash payments are received.

The allowance for loan losses is maintained at an amount management considers adequate to cover estimated losses in loans receivable which are deemed probable and estimable. The allowance is based upon a number of factors, including, but not limited to, asset classifications, the size and mix of the loan portfolio, economic trends and conditions, industry experience and trends, industry and geographic concentrations, estimated collateral values, management's assessment of the credit risk inherent in the portfolio, historical loan loss experience, changes in non-performing and past due loans, and the Company's underwriting policies.

General valuation allowances represent loss allowances that have been established to recognize inherent risk associated with lending activities, but which, unlike specific allowances, have not been allocated to particular problem assets.

In addition to the requirements of Accounting Principles Generally Accepted in the United States of America, or "GAAP", related to loss contingencies, a federally chartered savings association's determination as to the classification of its assets and the amount of its valuation allowances is subject to review by the OTS. The OTS, in conjunction with other federal banking agencies, provides guidance for financial institutions on both the responsibilities of management for the assessment and establishment of adequate allowances and guidance for banking agency examiners to use in determining the adequacy of general valuation allowances. It is required that all institutions:

o have effective systems and controls to identify, monitor, and address asset quality problems

o analyze all significant factors that affect the collectibility of the loan portfolio in a reasonable manner

o establish acceptable allowance evaluation processes that meet the objectives of the federal regulatory agencies

Various regulatory agencies, in particular the OTS, as an integral part of their examination process, periodically review the Company's allowance for loan losses. These agencies may require the Company to make additional provisions for loan losses, based on their judgments of the information available at the time of the examination. Although management believes that the allowance for loan losses is adequate to provide for estimated inherent losses in the loan portfolio, future provisions charged against operations will be subject to continuing evaluations of the inherent risk in the loan portfolio. In addition, if the national or local economy declines or asset quality deteriorates, additional provisions could be required. Such additional provisions could negatively and materially impact the Company's financial condition and results of operations.

The following table presents information concerning the Company's allowance for loan losses at the dates and for the years indicated.

(Dollars In Thousands)	2000	1999	1998
Period end loans outstanding (1)	$ 397,184	$ 364,188	$ 303,732
Average loans outstanding (1)	379,823	339,036	259,358
Period end non-performing loans outstanding	4,741	8,182	2,915
Allowance for loan losses			
Balance, at beginning of year	$ 3,502	$ 2,780	$ 1,669
Charge-offs:			
Residential one to four unit real estate loans	(371)	(113)	--
Other consumer loans	--	--	--
Total charge-offs	(371)	(113)	--
Recoveries:			
Residential one to four unit real estate loans	58	--	3
Other consumer loans	--	--	--

Total recoveries	58	--	3
Net (charge-offs) recoveries	(313)	(113)	3
Provision charged to operations	2,175	835	692
Allowance acquired in conjunction with loan purchase	--	--	416
Balance, at end of year	$ 5,364	$ 3,502	$ 2,780
Net charge-offs (recoveries) to average gross loans outstanding	0.08%	0.03%	--
Allowance as a percent of year end loans outstanding (1)	1.35%	0.96%	0.92%
Allowance as a percent of non-performing loans	113.14%	42.80%	95.37%

The charge-offs recorded by the Company in 2000 stemmed from a single residential mortgage. This loan was adversely impacted by substantial earth movement which significantly damaged the house and altered the parcel. The Company has been working with the borrower to address this situation, and recorded a $55 thousand partial recovery before the end of 2000.

The following table provides a summary of the allocation of the allowance for loan losses for specific loan categories at the dates indicated. The allocation presented should not be interpreted as an indication that charges to the allowance for loan losses will be incurred in these amounts or proportions, or that the portion of the allowance allocated to each loan category represents the total amounts available for future losses that may occur within these categories. The unallocated portion of the allowance and the total allowance is applicable to the entire loan portfolio.

	At December 31,							
	2000		1999		1998		1997	
(Dollars In Thousands)	Amount	% Of Loans In Category To Gross Loans	Amount	% Of Loans In Category To Gross Loans	Amount	% Of Loans In Category To Gross Loans	Amount	% Loans Categ To Gr Lo
Residential	$ 1,143	37.8%	$ 663	43.4%	$ 925	56.1%	$ 744	70
Multifamily	470	18.1%	185	10.9%	277	10.2%	260	8
Commercial real estate	1,232	24.1%	918	18.6%	514	12.2%	226	7
Construction	1,164	13.9%	960	20.3%	533	15.7%	209	12
Land	400	3.9%	137	3.6%	101	2.4%	54	0
Home equity lines of credit	32	1.3%	32	1.0%	34	1.0%	38	1
Other consumer loans	11	0.2%	15	0.2%	11	0.2%	19	0
Business term loans	148	0.4%	243	1.7%	190	2.0%	19	0

Business lines of credit	25	0.3%	83	0.3%	26	0.2%	19	0
Total allocated	4,625	100.0%	3,236	100.0%	2,611	100.0%	1,588	100
Unallocated	739		266		169		81	
Total	$5,364		$3,502		$2,780		$1,669	
Other information								
Gross loans outstanding	$423,945		$388,198		$327,876		$287,562	

Over the past several years, the Company has increased its allowance for loan losses in conjunction with three key trends within the loan portfolio:

- The growth in the nominal size of the loan portfolio has led management to increase the amount of the allowance.

- The greater diversification in the mix of the loan portfolio away from residential one to four unit permanent mortgages toward other types of lending, particularly income property and construction loans, has led to higher nominal and relative allowance levels, as these newer types of lending typically present more risk than residential mortgages. This increased risk stems both from the nature of the lending and the greater individual credit amounts associated with income property and construction loans.

- The increasing concentration of the portfolio in relatively less seasoned credits, because of the Company's growth rate in recent years, has also led management to increase the level of the allowance, as less seasoned loans typically present greater risk than loans which have been performing for many years.

The Company's loan portfolio at December 31, 2000 presented significant geographic concentration, consistent with the Company's focus of serving local individuals and businesses as a community commercial bank. The majority of the Company's loans outstanding at December 31, 2000 were secured by real estate located in the three counties which constitute the Company's primary market area:

- Santa Cruz County

- Monterey County

- Santa Clara County

This concentration provides certain benefits. For example, the Company becomes well known in its local area and therefore attracts more business. In addition, management develops a more comprehensive knowledge of real estate values and business trends in markets where lending is regularly conducted. However, this concentration also presents certain risks. A natural disaster such as an earthquake centered in the Greater Monterey Bay Area would impact the Company more significantly than firms with loans geographically dispersed over a wider area. Another concentration risk is that a downturn in the economy or real estate values in the Greater Monterey Bay Area would disproportionately unfavorably impact the Company versus a State-wide or national lender. The geographic concentration of the Company's loans is an important factor that management considers in determining appropriate levels of general loan loss reserves.

At December 31, 2000, the Company had outstanding less than $15.0 million in loans outside the State of California, with a majority of such associated with the Special Residential Loan Pool (see Note 15 to the Consolidated Financial Statements). The Company's strategic plan does not include substantial lending in 2001 outside the State of California. The Company does, however, intend to pursue the purchase of loans, particularly income property loans, in Northern and Southern California during 2001.

The Company increased the amount of the unallocated allowance during 2000 in response to a number of trends and factors which in management's opinion increased the inherent loss in the loan portfolio at December 31, 2000:

- the California energy crisis, with impacts upon the availability and price of electricity, business costs, consumer spending and disposable income, and the pace of economic activity in the State

- the financial difficulties experienced by many technology related companies in the Silicon Valley area adjacent to the Bank's primary market areas

- the impact of lower technology stock prices on consumer spending, liquidity, and investment, with a particular concern regarding effects on the demand and pricing for real estate in the Bank's primary market areas

- the general reduction in national economic growth and the increased volume of layoffs being announced by major corporations

To the extent that the Company is successful in its strategic plan and therefore continues to expand its loan portfolio and to increase the proportion of non-residential loans therein, management anticipates increasing, in future periods, the allowance for loan losses in a manner consistent with the Company's loan loss allowance methodology.

Investment Activities

Cash Equivalents. The Company does not include certain short term, highly liquid investments as investment securities, instead classifying these as cash equivalents. These include:

- federal funds sold

- securities purchased under agreements to resell

- commercial paper

- money market mutual fund investments

- banker's acceptances

- certificates of deposit in federally insured financial institutions

Liquidity Maintenance. Federally chartered savings institutions have the authority to invest in various types of liquid assets, as defined in applicable regulations, including United States Treasury obligations, securities of or guaranteed by various federal agencies, certificates of deposit of insured banks and savings institutions, bankers' acceptances, repurchase agreements, and federal funds. Additionally, the Bank must maintain minimum levels of investments that qualify as liquid assets under OTS regulations. See "Regulation And Supervision - Liquidity." Historically, the Bank has maintained liquid assets above the minimum OTS requirements and at a level considered to be adequate to meet foreseeable operational needs.

Investment Policies. In addition to the above liquid assets, subject to various restrictions, federally chartered savings institutions may also invest in various other types of securities, including investment-grade corporate debt securities, asset-backed securities, collateralized mortgage obligations not guaranteed by a federal agency, and mutual funds whose assets conform to the investments that a federally chartered savings institution is otherwise authorized to make directly. The Company maintains separate internal investment policies for the Bank and MBBC. These policies are established by the Board of Directors with the key objectives of:

o providing and maintaining liquidity

o generating a favorable total return on a risk-adjusted basis

o managing the overall interest rate risk profile of the entities

o maintaining compliance with various associated regulations

o controlling credit risk exposure

Specifically, the Company's policies generally limit investments to publicly traded securities that are investment grade. These policies prohibit the Company's maintenance of a trading portfolio as defined under SFAS No. 115.

Accounting And Reporting. Investment securities classified as available for sale are recorded at fair value, while investment securities classified as held to maturity are recorded at cost. Unrealized gains or losses on available for sale securities, net of the deferred tax effect, are reported as a component of other comprehensive income and are included in stockholders' equity.

The amortized cost and estimated fair value of securities are presented in the following tables:

	December 31, 2000		
(Dollars In Thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses
Available for sale			
Corporate trust preferreds	$ 7,696	$ --	$ (336)
FHLMC certificates	1,090	13	--
FNMA certificates	4,220	30	(2)
GNMA certificates	1,060	--	(11)
Collateralized mortgage obligations:			
Agency issuance	19,095	5	(266)

Non Agency issuance	18,210	4	(498)
	$ 51,371	$ 52	$(1,113)

	December 31, 1999		
(Dollars In Thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses
Available for sale			
Corporate trust preferreds	$ 11,456	$ 50	$ (43)
FHLMC certificates	1,930	--	(36)
FNMA certificates	25,132	95	(379)
GNMA certificates	4,531	--	(96)
Collateralized mortgage obligations:			
Agency issuance	11,152	--	(974)
Non Agency issuance	16,965	--	(604)
	$ 71,166	$ 145	$(2,132)
Held to maturity			
FNMA certificates	$ 60	$ --	$ --

	December 31, 1998		
(Dollars In Thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses
Available for sale			
Corporate trust preferreds	$ 18,658	$ 496	$ --
FNMA debentures	252	4	--
FHLMC certificates	4,735	28	--
FNMA certificates	32,870	891	(10)
GNMA certificates	11,927	39	(20)
Collateralized mortgage obligations:			
Agency issuance	13,945	14	(124)
Non Agency issuance	33,681	89	(59)
	$ 116,068	$ 1,561	$ (213)
Held to maturity			
FNMA certificates	$ 97	$ --	$ (1)

At December 31, 2000, the Company's investment in corporate trust preferred securities was entirely composed of variable rate securities which reprice quarterly based upon a margin over the three month LIBOR rate. These corporate trust preferred securities were also all rated "A-" or better by Standard & Poors ratings agency at December 31, 2000.

The following table presents certain information regarding the amortized cost, fair value, weighted average yields, and contractual maturities of the Company's securities as of December 31, 2000.

	At December 31, 2000			
	2001	2002 Through 2005	2006 Through 2010	Therea
	(Dollars In Thousands)			
Available for sale securities (1)				
Corporate trust preferreds	$ --	$ --	$ --	$ 7
FHLMC certificates	--	--	--	1
FNMA certificates	--	--	3,015	1
GNMA certificates	--	--	811	
Collateralized mortgage obligations:	--	--		
Agency issuance	406	--	3,746	14
Non Agency issuance	--	--	--	18
Total amortized cost	$ 406	$ --	$ 7,572	$ 43
Estimated fair value	$ 407	$ --	$ 7,558	$42
Weighted average yield (2)	8.21%	--	6.64%	6

The Company maintained no tax-preferenced securities at December 31, 2000. At December 31, 2000, the Company did not own debt securities issued by any one issuer that exceeded ten percent of stockholders' equity. For additional information regarding the Company's securities, please refer to Notes 3 and 4 to the Consolidated Financial Statements.

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Sources Of Funds

General. The Company's primary sources of funds are customer deposits, principal, interest, and dividend payments on loans and securities, FHLB advances and other borrowings, and, to a lesser extent, proceeds from sales of securities and loans. While maturities and scheduled amortization of loans and securities are predictable sources of funds, deposit flows and loan and security prepayments are greatly influenced by general interest rates, economic conditions, and competition.

Deposits. The Company offers a variety of deposit accounts with a range of interest rates and terms. The Company's deposits consist of demand deposit and NOW checking accounts, savings accounts, money market accounts, and certificates of deposit. The flow of deposits is influenced significantly by general economic conditions, changes in money market rates, prevailing interest rates, and competition. The Company's deposits are obtained predominantly from the areas in which its branch offices are located. The Company relies primarily on customer service and long standing relationships with customers to attract and retain these deposits; however, market interest rates and rates offered by competing financial institutions and mutual funds significantly affect the Company's ability to attract and retain deposits. While the Bank is currently eligible to accept brokered deposits, it has not done so. The Bank participates in the State of California Time Deposit Program, whereby the State places certificates of deposit with banks as a means of encouraging lending back into California's communities. Management continually monitors the Company's certificate accounts and historically the Company has retained a large portion of such accounts upon maturity.

In recent years, the Company has introduced a series of money market accounts specifically designed for certain target markets. For example, in 2000 the Company introduced a highly tiered money market account specifically designed to attract higher average balance depositors who might otherwise pursue money market mutual funds. As a result, money market deposit balances have increased in recent years, from $60.5 million at December 31, 1998 to $81.2 million at December 31, 1999 to $87.7 million at December 31, 2000. The Company plans to further refine and augment its money market account product line in 2001 following its conversion to a new core data processing system.

The Company's other area of focus in deposit acquisition in recent years has been checking accounts, coincident with the Company's business strategy of becoming more of a community based financial services organization, meeting the primary financial needs of both consumers and small businesses. The Company has enjoyed particular success with its "40 +" checking product, a NOW account that provides free checking to customers 40 years of age or older meeting certain other minimum requirements. In 2000, the Company introduced its Interest Checking Plus product, a SuperNow account that provides relatively higher, tiered interest rates for those consumers who maintain more substantial balances in their checking accounts. This product has averaged in excess $25 thousand per account, providing the Company with efficiencies versus typical consumer checking accounts that contain much smaller average balances. In 2001, the Company plans to continue building its base of business checking accounts, including demand deposits on account analysis, consistent with sales efforts by the new Professional Banking and Commercial Banking Groups. Checking accounts expanded from 10.1% of total deposits at December 31, 1998 to 13.3% at December 31, 1999 to 14.4% at December 31, 2000.

In preparation for its planned systems conversion in 2001, during the fourth quarter of 2000 and during the first quarter of 2001, the Company took steps to convert all of its passbook based deposit accounts to statement based deposit accounts, specifically certain savings and certificate of deposit products. The Company chose not to continue supporting passbook based deposits post conversion to the new data processing system, as management believes passbook based products do not integrate effectively with the increasingly numerous and varied means of customer electronic access to their funds; e.g. Internet banking, electronic bill payment, debit / point of sale, ATM networks, and telephone banking.

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During 2000, the Company's certificate of deposit portfolio increased by $22.6 million, of which $14.0 million represented inflows from the State of California Time Deposit Program. During the past two years, the Company has focused its deposit related sales efforts on transaction accounts as a means of increasing net interest margins, bolstering fee income, and building more comprehensive customer relationships. In addition, during 2000, the Company encountered significant price competition for certificates of deposit from one very large thrift in particular, and from Internet banks seeking to build their customer bases through aggressive pricing without regard to short term profitability.

The Company's weighted average cost of deposits at December 31, 2000 was 4.72%, equal to 90 basis points below the 11th District Cost Of Funds Index ("COFI") for December 2000 of 5.62%. While COFI contains funding components other than deposits, the Company uses a comparison to COFI as a benchmark of its success in managing its cost of deposits. The Company's cost of deposits was 81 basis points below COFI at December 31, 1999. The Company seeks to manage its cost of deposits both via pricing for individual products and through the deposit portfolio product mix.

The Company maintained no deposits in foreign banking offices at December 31, 2000 or December 31, 1999.

The following table presents the deposit activity of the Company for the periods indicated.

	For The Year Ended	
	2000	
	(Dollars In Th	
Deposits	$ 1,585,674	$ 1,205
Purchased deposits	--	
Withdrawals	(1,562,500)	(1,223
Net deposits	23,174	(18
Interest credited on deposits	17,212	15
Total increase (decrease) in deposits	$ 40,386	$ (3

The following table summarizes the Company's deposits at the dates indicated.

	December 31, 2000		Decem
(Dollars In Thousands)	Balance	Weighted Average Rate	Balance
Demand deposit accounts	$ 17,065	--	$ 17,316
NOW accounts	41,859	1.53%	31,385
Savings accounts	16,503	1.96%	15,312
Money market accounts	87,651	4.78%	81,245
Certificates of deposit <$100,000	166,905	5.68%	169,646
Certificates of deposit $100,000 or more	77,805	5.97%	52,498

	$407,788		$367,402
	========		========
Weighted average nominal interest rate		4.72%	

The weighted average interest rates are at the end of the period and are based upon stated interest rates without giving consideration to daily compounding of interest or forfeiture of interest because of premature withdrawal.

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The following table presents the amount and weighted average rate of time deposits equal to or greater than $100,000 at December 31, 2000. The amount maturing in three months or less includes $14.0 million associated with the State of California Time Deposit Program.

(Dollars In Thousands)	At December 31, 2000 Amount	Weighted Average Rate
Maturity Period		
Three months or less	$ 40,309	5.98%
Over three through 6 months	14,117	5.90%
Over 6 through 12 months	14,128	6.00%
Over 12 months	9,251	6.00%
	$ 77,805	5.97%

The following table presents the distribution of the Company's average balances of deposit accounts for the periods indicated and the weighted average interest rates on each category of deposits presented.

	For The Year Ended December 31, 2000			1999			
	Average Balance	% Of Average Total Deposits	Weighted Average Rate	Average Balance	% Of Average Total Deposits	Weighted Average Rate	Averag Balanc
				(Dollars In Thousands)			
Demand deposits	$ 16,719	4.3%	--	$ 17,610	4.8%	--	$ 15,40
NOW accounts	36,317	9.4%	1.51%	25,205	6.8%	1.54%	14,53
Savings accounts	15,803	4.1%	1.78%	15,583	4.2%	1.80%	15,20
Money market accounts	87,733	22.7%	4.60%	82,006	22.2%	4.15%	42,60
Certificates of deposit	230,099	59.5%	5.37%	229,493	62.0%	4.82%	266,22
Total	$386,671	100.0%	4.45%	$369,897	100.0%	4.09%	$353,96

Please refer to Note 10 to the Consolidated Financial Statements for additional information concerning deposits.

Borrowings

From time to time, the Company obtains borrowed funds through FHLB advances, federal funds purchased, and securities sold under agreements to repurchase as alternatives to retail deposit funds, and may do so in the future as part of its operating strategy. Borrowings are also utilized to acquire certain other assets as deemed appropriate by management for investment purposes and to better utilize the capital resources of the Bank and Company. Borrowings are also used as a tool in the Company interest rate risk management process.

FHLB advances are collateralized by the Bank's pledged mortgage loans, pledged mortgage backed securities, and investment in the capital stock of the FHLB. See "Regulation And Supervision - Federal Home Loan Bank System." FHLB advances are made pursuant to several different credit programs with varying interest rate, embedded option (callable / putable), amortization, and maturity terms. All of the Bank's FHLB advances outstanding at December 31, 2000 were fixed rate, non-amortizing advances with single individual maturity dates ("bullet advances"). The maximum amount that the FHLB will advance to member institutions, including the Bank, fluctuates from time to time in accordance with the policies of the FHLB. During 2000, the Bank periodically used FHLB advances to provide needed liquidity and to supplement deposit gathering activity.

From time to time, the Company enters into reverse repurchase agreements (securities sold under agreements to repurchase) with approved security dealers. Over the past several years, MBBC has in particular utilized securities sold under agreements to repurchase, as the holding company is not eligible for obtaining FHLB advances.

The Bank maintains federal funds lines of credit with four correspondent banks. These lines are not committed lines, but rather function on a funds availability basis. From time to time, the Bank borrows federal funds from its correspondent banks as a source of short term liquidity.

MBBC maintains a committed $2.0 million revolving line of credit with one of the Bank's correspondent banks. This line of credit expires in November, 2001, although it is the intention of MBBC to renew the facility. Funds drawn on the line are priced based upon either the London InterBank Offer Rate curve ("LIBOR") or the correspondent bank's reference rate. This line of credit contains various covenants and certain restrictions on the use of funds.

The following table sets forth information regarding the Company's borrowed funds at or for the indicated years.

(Dollars In Thousands)	At Or For The Year Ended	
	2000	199
FHLB Advances		
Average balance outstanding	$ 43,946	$ 37,60

Weighted average rate on average balance outstanding	5.72%	5.53
Year end balance outstanding	$ 32,582	$ 49,58
Weighted average rate on year end balance outstanding	5.48%	5.65
Maximum amount outstanding at any month end during the year	$ 50,582	$ 49,58
Securities Sold Under Agreements To Repurchase		
Average balance outstanding	$ 155	$ 3,18
Weighted average rate on average balance outstanding	6.45%	5.65
Year end balance outstanding	$ --	$2,41
Weighted average rate on year end balance outstanding	--	6.08
Maximum amount outstanding at any month end during the year	$ --	$ 4,35

Please refer to Notes 11, 12, and 13 to the Consolidated Financial Statements for additional information regarding borrowings and lines of credit.

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Subsidiary Activities

Portola, a California corporation wholly owned by the Bank, is engaged, on an agency basis, in the sale of insurance, mutual funds, individual securities, and annuity products, primarily to the Bank's customers and members of the local communities which the Bank serves. During 2000, gross commission income generated through Portola included $334 thousand for variable annuity sales, $134 thousand for mutual fund sales, and $71 thousand for fixed annuity sales. Portola also functions as trustee for the Bank's deeds of trust. At December 31, 2000, Portola had $157 thousand in total assets. Portola recorded a net loss of $25 thousand for the year ended December 31, 2000. In early 2001, Portola hired a new President with significant related experience.

Personnel

As of December 31, 2000, the Company had 120 full-time employees and 17 part-time employees. The employees are not represented by a collective bargaining unit. The Company considers its relationship with its employees to be good.

REGULATION AND SUPERVISION

General

Savings and loan holding companies and savings associations are extensively regulated under both federal and state law. This regulation is intended primarily for the protection of depositors and the Savings Association Insurance Fund ("SAIF") and not for the benefit of stockholders of the Company. The following information describes certain aspects of that regulation applicable to the Company and the Bank, and does not purport to be complete. The following discussion is qualified in its entirety by reference to all particular statutory or regulatory provisions.

Regulation of the Company

General. The Company is a unitary savings and loan holding company subject to regulatory oversight by the Office of Thrift Supervision ("OTS"). As such, the Company is required to register and file reports with the OTS and is subject to regulation and examination by the OTS. In addition, the OTS has enforcement authority over the Company and its subsidiaries, which also permits the OTS to restrict or prohibit activities that are determined to be a serious risk to the subsidiary savings association.

Although savings and loan holding companies are not, at December 31, 2000, subject to specific capital requirements (see Activities Restriction Test, below) or specific restrictions on the payment of dividends or other capital distributions, the Home Owners Loan Act ("HOLA") does prescribe such restrictions on subsidiary savings institutions, as described below. The Bank must notify the OTS 30 days before declaring any dividend to MBBC.

The HOLA prohibits a savings and loan holding company directly, or indirectly, or through one or more subsidiaries, from acquiring more than 5% of the voting stock of another savings institution or holding company thereof, without prior written approval of the OTS; acquiring or retaining, with certain exceptions, more than 5% of a non-subsidiary company engaged in activities other than those permitted by the HOLA; or acquiring or retaining control of a depository institution that is not insured by the FDIC. In evaluating applications by holding companies to acquire savings institutions, the OTS must consider the financial and managerial resources and future prospects of the company and institution involved, the effect of the acquisition on the risk to the deposit insurance funds, the convenience and needs of the community, and competitive factors.

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Activities Restriction Test. As a unitary savings and loan holding company, the Company generally is not subject to activity restrictions, provided the Bank satisfies the Qualified Thrift Lender ("QTL") test or meets the definition of domestic building and loan association pursuant to the Internal Revenue Code of 1986, as amended (the "Code"). The Company presently intends to continue to operate as a unitary savings and loan holding company. Recent legislation terminated the "unitary thrift holding company exemption" for all companies that apply to acquire savings associations after May 4, 1999. Since the Company is grandfathered, its unitary holding company powers and authorities were not affected. See "Financial Services Modernization Legislation." However, if the Company acquires control of another savings association as a separate subsidiary, it would become a multiple savings and loan holding company, and the activities of the Company and any of its subsidiaries (other than the Bank or any other SAIF-insured savings association) would become subject to restrictions applicable to bank holding companies unless such other associations each also qualify as a QTL or domestic building and loan association and were acquired in a supervisory acquisition. Furthermore, if the Company were in the future to sell control of the Bank to any other company, such company would not succeed to the Company grandfathered status under and would be subject to the same business activity restrictions. See "Qualified Thrift Lender Test."

On October 27, 2000, the OTS issued a proposed rule that would require some savings and loan holding companies to notify the OTS 30 days before undertaking certain significant new business activities. As proposed, thrift companies would have to give the OTS advance notice if:

- debt, combined with all other transactions by MBBC or any subsidiaries other than the thrift during the past 12 months, increases non-thrift liabilities by 5 percent or more; and non-thrift liabilities, after the debt transaction, equal 50 percent or more of the company's consolidated core capital;

- an asset acquisition or series of such transactions by MBBC or non-thrift subsidiary during the past 12 months that involves assets other than cash,

cash equivalents and securities or other obligations guaranteed by the U.S. Government and exceeds 15 percent of MBBC's consolidated assets; and

o any transaction that, when combined with all other transactions during the past 12 months, reduces the Company's capital by 10 percent or more.

Exempt from the notice requirement would be any holding company with consolidated subsidiary thrift assets of less than 20 percent of total assets or consolidated holding company capital of at least 10 percent. The OTS could object to or conditionally approve an activity or transaction if it finds a material risk to the safety and soundness and stability of the thrift. The review period could be extended an additional 30 days if necessary.

The OTS proposal also would codify current practices and the factors relevant to a holding company's need for capital. To determine the need for and level of an explicit holding company capital requirement, the OTS will look at overall risk at the thrift and the consolidated entity, their tangible and equity capital, whether the holding company's debt-to-capital ratio is rising, what investments or activities are funded by debt, its cash flow, how much the holding company relies on dividends from subsidiary thrift to service debt or fulfill other obligations, earnings volatility and the thrift's standing in the corporate structure.

The comment period for the proposed rule was extended to February 9, 2001.

Restrictions on Acquisitions. MBBC must obtain approval from the OTS before acquiring control of any other SAIF-insured association. The OTS is prohibited from approving any acquisition that would result in a multiple savings and loan holding company controlling savings institutions in more than one state, subject to two exceptions: (i) the approval of interstate supervisory acquisitions by savings and loan holding companies and (ii) the acquisition of a savings institution in another state if the laws of the state of the target savings institution specifically permit such acquisitions. The states vary in the extent to which they permit interstate savings and loan holding company acquisitions.

Federal law generally provides that no "person," acting directly or indirectly or through or in concert with one or more other persons, may acquire "control," as that term is defined in OTS regulations, of a federally insured savings association without giving at least 60 days written notice to the OTS and providing the OTS an opportunity to disapprove the proposed acquisition. In addition, no company may acquire control of such an institution without prior OTS approval. These provisions also prohibit, among other things, any director or officer of a savings and loan holding company, or any individual who owns or controls more than 25% of the voting shares of a savings and loan holding company, from acquiring control of any savings association not a subsidiary of the savings and loan holding company, unless the acquisition is approved by the OTS. For additional restrictions on the acquisition of a unitary thrift holding company, see "- Financial Services Modernization Legislation."

Financial Services Modernization Legislation

General. On November 12, 1999, President Clinton signed into law the Gramm-Leach-Bliley Act of 1999 (the "Financial Services Modernization Act"). The Financial Services Modernization Act repeals the two affiliation provisions of the Glass-Steagall Act:

o Section 20, which restricted the affiliation of Federal Reserve Member

Banks with firms "engaged principally" in specified securities activities; and

- Section 32, which restricts officer, director, or employee interlocks between a member bank and any company or person "primarily engaged" in specified securities activities.

In addition, the Financial Services Modernization Act also contains provisions that expressly preempt any state law restricting the establishment of financial affiliations, primarily related to insurance. The general effect of the law is to establish a comprehensive framework to permit affiliations among commercial banks, insurance companies, securities firms, and other financial service providers by revising and expanding the Bank Holding Company Act framework to permit a holding company system to engage in a full range of financial activities through a new entity known as a "Financial Holding Company." "Financial activities" is broadly defined to include not only banking, insurance, and securities activities, but also merchant banking and additional activities that the Federal Reserve Board, in consultation with the Secretary of the Treasury, determines to be financial in nature, incidental to such financial activities, or complementary activities that do not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally.

The Financial Services Modernization Act provides that no company may acquire control of an insured savings association unless that company engages, and continues to engage, only in the financial activities permissible for a Financial Holding Company, unless grandfathered as a unitary savings and loan holding company. The Financial Institution Modernization Act grandfathers any company that was a unitary savings and loan holding company on May 4, 1999 or became a unitary savings and loan holding company pursuant to an application pending on that date. Such a company may continue to operate under present law as long as the company continues to meet the two tests: it can control only one savings institution, excluding supervisory acquisitions, and each such institution must meet the QTL test. Such a grandfathered unitary savings and loan holding company also must continue to control at least one savings association, or a successor institution, that it controlled on May 4, 1999.

The Financial Services Modernization Act also permits national banks to engage in expanded activities through the formation of financial subsidiaries. A national bank may have a subsidiary engaged in any activity authorized for national banks directly or any financial activity, except for insurance underwriting, insurance investments, real estate investment or development, or merchant banking, which may only be conducted through a subsidiary of a Financial Holding Company. Financial activities include all activities permitted under new sections of the Bank Holding Company Act or permitted by regulation.

The Company and the Bank do not believe that the Financial Services Modernization Act has had or will have a material adverse effect on the operations of the Company and the Bank in the near-term. However, to the extent that the act permits banks, securities firms, and insurance companies to affiliate, the financial services industry may experience further consolidation. The Financial Services Modernization Act is intended to grant to community banks certain powers as a matter of right that larger institutions have accumulated on an ad hoc basis and which unitary savings and loan holding companies already possess. Nevertheless, this Act may have the result of increasing the amount of competition that the Company and the Bank face from larger institutions and other types of companies offering financial products, many of which may have substantially more financial resources than the Company and the Bank. In addition, because the Company may only be acquired by other unitary savings and loan holding companies or Financial Holding Companies, the legislation may have an anti-takeover effect by limiting the number of potential acquirors or by increasing the costs of an acquisition transaction by a bank holding company that has not made the election to be a Financial Holding Company under the new legislation.

Privacy. Under the Financial Services Modernization Act, federal banking regulators are required to adopt rules that will limit the ability of banks and other financial institutions to disclose non-public information about consumers to nonaffiliated third parties. Federal banking regulators issued final rules on May 10, 2000. Pursuant to those rules, financial institutions must provide:

- o initial notices to customers about their privacy policies, describing the conditions under which they may disclose nonpublic personal information to nonaffiliated third parties and affiliates;
- o annual notices of their privacy policies to current customers; and
- o a reasonable method for customers to "opt out" of disclosures to nonaffiliated third parties.

The rules were effective November 13, 2000, but compliance is optional until July 1, 2001. These privacy provisions will affect how consumer information is transmitted through diversified financial companies and conveyed to outside vendors. It is not possible at this time to assess the impact of the privacy provisions on the Company's financial condition or results of operations.

Consumer Protection Rules - Sale of Insurance Products. In December 2000, pursuant to the requirements of the Financial Services Modernization Act, the federal bank and thrift regulatory agencies adopted consumer protection rules for the sale of insurance products by depository institutions. The rule is effective on April 1, 2001. The final rule applies to any depository institution or any person selling, soliciting, advertising, or offering insurance products or annuities to a consumer at an office of the institution or on behalf of the institution. Before an institution can complete the sale of an insurance product or annuity, the regulation requires oral and written disclosure that such product:

- o is not a deposit or other obligation of, or guaranteed by, the depository institution or its affiliate;
- o is not insured by the FDIC or any other agency of the United States, the depository institution or its affiliate; and
- o has certain risks in investment, including the possible loss of value.

Finally, the depository institution may not condition an extension of credit:

- o on the consumer's purchase of an insurance product or annuity from the depository institution or from any of its affiliates, or
- o on the consumer's agreement not to obtain, or a prohibition on the consumer from obtaining, an insurance product or annuity from an unaffiliated entity.

The rule also requires formal acknowledgement from the consumer that disclosures were received.

In addition, to the extent practicable, a depository institution must keep insurance and annuity sales activities physically segregated from the areas where retail deposits are routinely accepted from the general public.

Safeguarding Confidential Customer Information. In January 2000, the banking agencies adopted guidelines requiring financial institutions to establish an information security program to:

- identify and assess the risks that may threaten customer information

- develop a written plan containing policies and procedures to manage and control these risks

- implement and test the plan

- adjust the plan on a continuing basis to account for changes in technology, the sensitivity of customer information, and internal or external threats to information security

Each institution may implement a security program appropriate to its size and complexity and the nature and scope of its operations.

The guidelines outline specific security measures that institutions should consider in implementing a security program. A financial institution must adopt those security measures determined to be appropriate. The guidelines require the Board of Directors to oversee an institution's efforts to develop, implement, and maintain an effective information security program and approve written information security policies and programs. The guidelines are effective July 1, 2001.

Regulation of the Bank

General. As a federally chartered, SAIF insured savings association, the Bank is subject to extensive regulation, examination, and supervision by the OTS, as its primary federal regulator, and the FDIC, as the insurer of customer deposits. The Bank must file reports with the OTS and the FDIC concerning its activities and financial condition. In addition, the Bank must obtain various regulatory approvals prior to conducting certain types of business or entering into selected transactions; e.g. mergers with, or acquisitions of, other financial institutions. Lending activities and other investments of the Bank must comply with various statutory and regulatory requirements. The relationship between the Bank and depositors and borrowers is also regulated by federal and state law, especially in such matters as the ownership of savings accounts and the form and content of mortgage documents utilized by the Bank. The OTS and / or the FDIC conduct periodic examinations to test the Bank's safety and soundness, its operations (including technology utilization), and its compliance with applicable laws and regulations, including, but not limited to:

- the Community Reinvestment Act ("CRA")

- the Real Estate Settlement Procedures Act ("RESPA")

- the Bank Secrecy Act ("BSA")

- the Fair Credit Reporting Act ("FCRA")

- the Home Mortgage Disclosure Act ("HMDA")

The regulatory structure provides the supervisory authorities extensive discretion across a wide range of the Company's operations, including, but not limited to:

- loss reserve adequacy
- capital requirements
- credit classification
- limitation or prohibition on dividends
- assessment levels for deposit insurance and examination costs
- permissible branching

Any change in regulatory requirements and policies, whether by the OTS, the FDIC, the Federal Reserve Board, or Congress, could have a material adverse impact on the Company.

Capital Requirements And Capital Categories

The following discussion regarding regulatory capital requirements is applicable to the Bank.

Capital Requirements. OTS capital regulations require savings institutions to meet three minimum capital standards (as defined by applicable regulations):

- a 1.5% tangible capital ratio
- a 3.0% leverage (core) capital ratio
- an 8.0% risk-based capital ratio

The capital standard applicable to savings institutions must be no less stringent than those for national banks. In addition, the prompt corrective action ("PCA") standards discussed below also establish, in effect, the following minimum standards:

- a 2.0% tangible capital ratio
- a 4.0% leverage (core) capital ratio (3.0% for institutions receiving the highest regulatory rating under the CAMELS rating system)
- a 4.0% Tier One risk based capital ratio

The OTS also has the authority, after giving the affected institution notice and an opportunity to respond, to establish specific minimum capital requirements for a single institution which are higher than the general industry minimum requirements presented above. The OTS can take this action upon a determination that a higher minimum capital requirement is appropriate in light of an institution's particular circumstances.

Tangible capital is composed of:

- common stockholders' equity (including retained earnings)
- certain noncumulative perpetual preferred stock and related earnings
- minority interests in equity accounts of consolidated subsidiaries

less:

- intangible assets other than certain asset servicing rights
- investments in and loans to subsidiaries engaged in activities as principal, not permissible for a national bank
- deferred tax assets as defined under Statement of Financial Accounting Standards ("SFAS") Number 109 - "Accounting for Income Taxes" in excess of certain thresholds

Core capital consists of tangible capital plus various adjustments for certain intangible assets. At December 31, 2000 and 1999, the Bank's tangible capital was equivalent to its core capital, as the Bank did not maintain any qualifying adjustments. In general, total assets calculated for regulatory capital purposes exclude those assets deducted from capital in determining the applicable capital ratio.

The risk based capital standard for savings institutions requires the maintenance of Tier One capital (core capital) and total capital (defined as core capital plus supplementary capital) to risk weighted assets of 4.0% and 8.0%, respectively. In determining the amount of an institution's risk weighted assets, all assets, including certain off balance sheet positions, are multiplied by a risk weight of 0.0% to 100.0%, as assigned by OTS regulations based upon the amount of risk perceived as inherent in each type of asset. The components of supplementary capital include:

- cumulative preferred stock
- long term perpetual preferred stock
- mandatory convertible securities
- certain subordinated debt
- intermediate preferred stock
- the general allowance for loan and lease losses, subject to a limit of 1.25% of risk weighted assets

Overall, the amount of supplementary capital included as part of total capital cannot exceed 100.0% of core capital.

A savings association with a greater than "normal" level of interest rate exposure must deduct an interest rate risk ("IRR") component in calculating its total capital for purposes of determining whether it meets its risk-based capital requirement. Interest rate exposure is measured, generally, as the decline in an institution's net portfolio value that would result from a 200 basis point increase or decrease in market interest rates (whichever would result in lower net portfolio value), divided by the estimated economic value of the savings association's assets. The interest rate risk component to be deducted from total capital is equal to one-half of the difference between an institution's measured exposure and "normal" IRR exposure (which is defined as 2%), multiplied by the estimated economic value of the institution's assets. In August 1995, the OTS indefinitely delayed implementation of its IRR regulation. Management believes that, were the OTS to proceed with implementation of its IRR capital regulation at December 31, 2000, the Bank would not have an associated incremental regulatory capital requirement.

As disclosed in Note 15 to the Consolidated Financial Statements, at December 31, 2000, the Bank exceeded all minimum regulatory capital requirements.

FDICIA PCA Regulations. The Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA") dictated that the OTS implement a system requiring regulatory sanctions against institutions that are not adequately capitalized, with severity of the sanctions increasing as the institution's capital declines. The OTS has established specific capital ratios under the PCA Regulations for five separate capital categories:

1. well capitalized

2. adequately capitalized

3. under capitalized

4. significantly under capitalized

5. critically undercapitalized

Under the OTS regulations implementing FDICIA, an insured depository institution will be classified in the following categories based, in part, on the following capital measures:

Well Capitalized	Under Capitalized
Total risk based capital ratio of at least 10.0%	Total risk based capital ratio of
Tier One risk based capital ratio of at least 6.0%	Tier One risk based capital ratio
Leverage ratio of at least 5.0%	Leverage ratio of less than 4.0%
Adequately Capitalized	Significantly Under Capitalized
Total risk based capital ratio of at least 8.0%	Total risk based capital ratio of
Tier One risk based capital ratio of at least 4.0%	Tier One risk based capital ratio
Leverage ratio of at least 4.0%	Leverage ratio of less than 3.0%
	Critically Under Capitalized
	Tangible capital of less than 2.0

An institution that, based upon its capital levels, is classified in one of the top three categories may be regulated as though it were in the next lower capital category if the appropriate federal banking agency, after notice and an opportunity for hearing, determines that the operation or status of the institution warrants such treatment. There are numerous mandatory supervisory restrictions on the activities of under capitalized institutions. An institution that is under capitalized must submit a capital restoration plan to the OTS that the OTS may approve only if it determines that the plan is likely to succeed in restoring the institution's capital and will not appreciably increase the risks to which the institution is exposed. In addition, the institution's performance under the capital restoration plan must be guaranteed by every company that controls the institution. Under capitalized institutions may not acquire an interest in any company, open a new branch office, or engage in a new line of business without OTS or FDIC approval. An under capitalized institution is also limited in its ability to increase average assets, accept brokered deposits, pay management fees, set deposit rates, and make capital distributions. Additional restrictions apply to significantly and critically under capitalized institutions. In addition, the OTS maintains extensive discretionary sanctions which may be applied to under capitalized institutions, including the issuance of a capital directive and replacement of officers and directors.

Adequately capitalized institutions may accept brokered deposits only with a waiver from the FDIC and are subject to restrictions on the interest rates that can be paid on such deposits. Under capitalized institutions may not accept, renew, or roll over brokered deposits. At December 31, 2000, the Bank was eligible to acquire brokered deposits, but had none.

As disclosed in Note 15 to the Consolidated Financial Statements, at December 31, 2000, the Bank met the requirements to be classified as a "well capitalized" institution under PCA regulations.

The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA") and FDICIA capital requirements are viewed as minimum standards by the OTS, and most institutions are expected to maintain capital levels well above the minimum. In addition, the OTS regulations provide that minimum capital levels higher than those provided in the regulations may be established by the OTS for individual savings associations, upon a determination that the savings association's capital is or may become inadequate in view of its circumstances. The OTS regulations provide that higher individual minimum regulatory capital requirements may be appropriate in circumstances where, among others:

- a savings association has a high degree of exposure to interest rate risk, prepayment risk, credit risk, concentration of credit risk, certain risks arising from nontraditional activities, or similar risks or a high proportion of off-balance sheet risk;

- a savings association is growing, either internally or through acquisitions, at such a rate that supervisory problems are presented that are not dealt with adequately by OTS regulations

- a savings association may be adversely affected by activities or condition of its holding company, affiliates, subsidiaries, or other persons, or savings associations with which it has significant business relationships.

Special OTS Capital Requirements. On March 6, 2000, the Bank was informed by the OTS that:

1. All loans associated with the pool of residential mortgages acquired from a seller / servicer that guaranteed the pool (the "Special Residential Loan Pool") be assigned to the 100% risk based capital category in calculating capital ratios that incorporate risk weighted assets. See "Credit Quality - Special Residential Loan Pool" and Note 15 to the Consolidated Financial Statements.

2. The Bank's regulatory capital position at December 31, 1999 was required to reflect this requirement.

3. Until further notice, the Bank's regulatory capital ratios were required to be maintained at levels no lower than the levels at December 31, 1999.

Management does not foresee any compliance issue resulting from these requirements given the Bank's regulatory capital position at December 31, 2000, and the expected continued generation of regulatory capital through retained earnings, the amortization of deferred stock compensation, and the amortization of intangible assets. Furthermore, the Company's maintenance of a "well capitalized" regulatory capital position is integral to its business plan.

In specifying the above requirements, the OTS did not request that the Bank restate any of its historic regulatory capital ratios for prior periods, before December 31, 1999, during which the Bank owned the specifically identified pool of purchased residential mortgages.

Regulatory Capital Requirements Associated With Sub-Prime Lending. As a result of a number of federally insured financial institutions extending their risk selection standards to attract lower credit quality accounts due to such credits having higher interest rates and fees, in March 1999, the federal banking regulatory agencies jointly issued Interagency Guidelines on Subprime Lending. In addition, expanded guidelines were issued by the agencies on January 31, 2001. Subprime lending involves extending credit to individuals with less than perfect credit histories.

These guidelines provide that if the risks associated with subprime lending are not properly controlled, the agencies consider subprime lending a high-risk activity that is unsafe and unsound. Specifically, the 2001 guidelines direct examiners to expect regulatory capital one and one-half to three times higher than that typically set aside for prime assets for institutions that:

o have subprime asset concentration of 25% Tier 1 capital or higher; or

o have subprime portfolios experiencing rapid growth or adverse performance trends, administered by inexperienced management, or having inadequate or weak controls.

The Bank does not normally engage in subprime lending. However, substantially all of the Special Residential Loan Pool (see "Credit Quality - Special Residential Loan Pool" and Note 15 to the Consolidated Financial Statements), if owned without the credit guaranty of the seller / servicer, would qualify as subprime lending under the characterics published by the OTS in early 2001. Management believes that the seller / servicer of the Special Residential Loan Pool has considerable experience in administering subprime residential mortgages.

Proposed Capital Requirements for Community Institutions. In November 2000, the federal bank and thrift regulatory agencies requested public comment on an advance notice of proposed rulemaking that considers the establishment of a simplified regulatory capital framework for non-complex institutions.

In the proposal, the agencies suggested criteria that could be used to determine eligibility for a simplified capital framework, such as the nature of a bank's activities, its asset size and its risk profile. In the advance notice, the agencies seek comment on possible minimum regulatory capital requirements for non-complex institutions, including a simplified risk-based ratio, a simple leverage ratio, or a leverage ratio modified to incorporate certain off-balance sheet exposures.

The advance notice solicits public comment on the agencies' preliminary views. Comments are due on the proposal on February 1, 2001. Given the preliminary nature of the proposal, it is not possible to predict its impact on the Bank at this time.

Safety and Soundness Standards

In addition to the PCA provisions discussed above based on an institution's regulatory capital ratios, FDICIA contains several measures intended to promote early identification of management problems at depository institutions and to ensure that regulators intervene promptly to require corrective action by institutions with inadequate operational and managerial controls. The OTS has established minimum standards in this regard related to:

- internal controls, information systems, and internal audit systems
- loan documentation
- credit underwriting
- asset growth
- earnings
- interest rate risk exposure
- compensation, fees, and benefits

If the OTS determines that an institution fails to meet any of these minimum standards, the agency may require the institution to submit to the agency an acceptable plan to achieve compliance with the standard. In the event the institution fails to submit an acceptable plan within the time allowed by the agency or fails in any material respect to implement an accepted plan; the agency must, by order, require the institution to correct the deficiency and may implement a series of supervisory sanctions.

Effective October 1, 1996, the federal banking agencies (including the OTS) promulgated safety and soundness regulations and accompanying interagency compliance guidelines on asset quality and earnings standards. These guidelines provide six standards for establishing and maintaining a system to identify problem assets and prevent those assets from deteriorating. The institution should:

1. conduct periodic asset quality reviews to identify problem assets
2. estimate the inherent losses in those assets and establish reserves that are sufficient to absorb estimated losses
3. compare problem asset totals to capital
4. take appropriate corrective action to resolve problem assets
5. consider the size and potential risks of material asset concentrations
6. provide periodic asset reports with adequate information for management and the board of directors to assess the level of asset risk

These guidelines also set forth standards for evaluating and monitoring earnings and for ensuring that earnings are sufficient for the maintenance of adequate capital and reserves. If the institution fails to comply with a safety and soundness standard, the appropriate federal banking agency may require the institution to submit a compliance plan. Failure to submit a compliance plan or to implement an accepted plan may result in enforcement action.

Potential Enforcement Actions

The OTS has primary enforcement responsibility over savings institutions and maintains the authority to bring actions against the institution and all institution affiliated parties, as defined under the applicable regulations, for unsafe or unsound practices in conducting their businesses or for violations of any law, rule, regulation, 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 the Bank), the imposition of civil money penalties, the issuance of directives to increase capital, the issuance of formal and informal agreements, the issuance of removal or prohibition orders against institution affiliated parties, and the imposition of restrictions under the PCA provisions of FDICIA. Federal law also establishes criminal penalties for certain violations.

Under the FDI Act, the FDIC has the authority to recommend to the Director of the OTS enforcement action to be taken with respect to a particular savings institution. If action is not taken by the Director of the OTS, the FDIC has authority to take such action under certain circumstances.

Additionally, a holding company's inability to serve as a source of strength to its subsidiary financial institutions could serve as an ancillary basis for regulatory action against the holding company. Neither MBBC, the Bank, or any subsidiary thereof are currently subject to any enforcement actions, other than the requirements for the Bank to allocate additional regulatory capital against one specific pool of purchased residential mortgages and to maintain regulatory capital ratios at levels no lower than the levels at December 31, 1999 until further notice. See "Credit Quality - Special Residential Loan Pool" and Note 15 to the Consolidated Financial Statements.

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Insurance of Deposit Accounts

The Bank's deposit accounts are presently insured by the SAIF, except for certain acquired deposits which are insured by the BIF, up to the maximum permitted by law. The SAIF and the BIF are administered by the FDIC. Insurance of deposits may be terminated by the FDIC upon a finding that the institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operation, or has violated any applicable law, regulation, rule, order, or condition imposed by the FDIC or the institution's primary regulator. The management of the Bank does not know of any practice, condition, or violation that might lead to the termination of deposit insurance.

The FDIC currently assesses its premiums based upon the insured institution's position on two factors:

1. the institution's capital category under PCA regulations

2. the institution's supervisory category as determined by the FDIC based upon supervisory information provided by the institution's primary federal regulator and other information deemed pertinent by the FDIC

The supervisory categories are:

- Group A: financially sound with only a few minor weaknesses

- Group B: demonstrates weaknesses that could result in significant deterioration

- Group C: poses a substantial probability of loss

Annual FDIC deposit insurance assessment rates as of January 1, 2001 were as follows:

As Of January 1, 2001	FDIC Deposit Insurance Rates Expressed In Terms Of Annual Cents Per $100 of Assessed Deposits		
	Group A	Group B	Group C
PCA Capital Category			
Well capitalized	0	3	17
Adequately capitalized	3	10	24
Under capitalized	10	24	27

As of January 1, 2001, the Bank had been notified by the FDIC that its deposit insurance assessment rate during the first half of calendar 2001 would be 3 basis points.

In addition to the deposit insurance premiums presented in the above table, both BIF and SAIF insured institutions must also pay FDIC premiums related to the servicing of Financing Corporation ("FICO") bonds. FICO is an agency of the federal government that was established to recapitalize the predecessor to the SAIF. These assessments will continue until the FICO bonds mature in 2017. The current annual assessment rate for the FICO bonds is approximately 2 basis points per annum on insured deposits.

Branching

OTS regulations permit nationwide branching by federally chartered savings institutions to the extent allowed by federal statute. This permits federal savings institutions to establish interstate networks and to geographically diversify their loan portfolios and lines of business. The OTS authority preempts any state law purporting to regulate branching by federal savings institutions. At this time, the Company's management has no plans to establish physical branches outside of California, although the Bank does serve customers domiciled outside of California via alternative delivery channels such as telephone, mail, the Internet, and ATM networks.

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Transactions With Related Parties

The Bank's authority to engage in transactions with related parties or "affiliates" (e.g., any company that controls or is under common control with an institution, including the Company and its non-savings institution subsidiaries) is limited by Sections 23A and 23B of the Federal Reserve Act ("FRA"). Section 23A limits the aggregate amount of covered transactions with any individual affiliate to 10% of the capital and surplus of the savings institution. The aggregate amount of covered transactions with all affiliates is limited to 20% of the savings institution's capital and surplus. A "covered transaction" includes:

o a loan or extension of credit to an affiliate

o a purchase of investment securities issued by an affiliate

o a purchase of assets from an affiliate, with some exceptions

o the acceptance of securities issued by an affiliate as collateral for a loan or extension of credit to any party o the issuance of a guarantee, acceptance, or letter of credit on behalf of an affiliate

Certain transactions with affiliates are required to be secured by collateral in an amount and of a type described in Section 23A and the purchase of low quality assets from affiliates is generally prohibited. Section 23B generally provides that certain transactions with affiliates, including loans and asset purchases, must be on terms and under circumstances, including credit standards, that are substantially the same or at least as favorable to the institution as those prevailing at the time for comparable transactions with non-affiliated companies. In addition, savings institutions are prohibited from lending to any affiliate that is engaged in activities that are not permissible for bank holding companies and no savings institution may purchase the securities of any affiliate other than a subsidiary.

OTS regulation generally excludes all non-bank and non-savings association subsidiaries of savings associations from treatment as affiliates, except to the extent that the OTS or Federal reserve decides to treat these subsidiaries as affiliates. The regulation also requires savings associations to make and retain records that reflect affiliate transactions in reasonable detail and provides that specific classes of savings associations may be required to give the OTS prior notice of affiliate transactions.

The Bank's authority to extend credit to executive officers, directors, and 10% shareholders, ("insiders"), as well as entities such persons control, is governed by Sections 22(g) and 22(h) of the FRA and Regulation O thereunder. Among other things, such loans are required to be made on terms substantially the same as those offered to unaffiliated individuals and to not involve more than the normal risk of repayment. Specific legislation created an exception for loans made pursuant to a benefit or compensation program that is widely available to all employees of the institution and does not give preference to insiders over other employees. Regulation O also places individual and aggregate limits on the amount of loans the Bank may make to insiders based, in part, on the Bank's capital position and requires certain Board approval procedures to be followed. For information concerning loans to executive officers and directors of the Company, please refer to Note 5 to the Consolidated Financial Statements.

Community Reinvestment Act

The Community Reinvestment Act ("CRA") generally requires most insured depository institutions to:

o identify and delineate the communities served through and by the institution's offices

o affirmatively meet the credit needs of their delineated communities, including low and moderate income neighborhoods

o market the types of credit the institution is prepared to extend within such communities

The CRA also requires the OTS to assess the performance of the institution in meeting the credit needs of its communities and to take such assessment into consideration in reviewing applications for mergers, acquisitions, and other transactions. An unsatisfactory CRA rating may be the basis for denying such an application. In addition, federal banking agencies may take compliance with CRA into account when regulating and supervising other activities.

An institution's CRA performance is assessed on the basis of the institution's actual lending, service, and investment performance. In connection with its assessment of the Bank's CRA performance, the OTS assigns one of the following ratings:

- outstanding
- satisfactory
- needs improvement
- substantial noncompliance

Based upon its most recent CRA examination, the Bank received a "satisfactory" CRA rating.

Fair Lending Laws

The Equal Credit Opportunity Act and the Fair Housing Act prohibit lenders from discriminating in their lending practices on the basis of characteristics specific in those statutes. A savings institution's failure to comply with these acts could result in the OTS, other federal regulatory agencies, or the Department of Justice taking enforcement action.

Qualified Thrift Lender Test

The HOLA requires thrift institutions to meet a qualified thrift lender ("QTL") test. A thrift institution is permitted to meet the QTL test in one of two alternative ways. Under the first method, in at least nine out of every twelve months, the thrift institution is required to maintain at least 65% of its "portfolio assets," defined as total assets less (i) specified liquid assets up to 20% of total assets, (ii) intangible assets, including goodwill and (iii) the value of property used to conduct business, in certain "qualified thrift investments." Assets constituting qualified thrift investments include residential mortgages, qualifying mortgage backed securities, educational loans, small business loans, and credit card loans. Certain other types of assets also qualify as "qualified thrift investments" up to certain limitations. These limited other types of assets include home equity lines of credit and consumer loans. Alternatively, savings institutions are permitted to meet the QTL test by qualifying as a "domestic building and loan association" under the Internal Revenue Code.

A savings institution that fails the QTL test is subject to certain operating restrictions and may be required to convert to a commercial bank charter. At December 31, 2000, the Bank maintained 70.9% of its portfolio assets in qualified thrift investments and, therefore, met the QTL test.

Loans To One Borrower Limitation

Under the HOLA, thrift institutions are generally subject to the limits on loans to one borrower applicable to national banks. Generally, thrift institutions may not make a loan or extend credit to a single or related group of borrowers in excess of 15% of its unimpaired capital and surplus. The term "unimpaired capital and surplus" is defined as an institution's regulatory capital, plus that portion of an institution's general valuation allowances that is not includable in the institution's regulatory capital. An additional amount may be lent, equal to 10% of unimpaired capital and surplus, if such loan is secured by readily marketable collateral, which is defined to include certain financial instruments and specifically excludes real estate. At December 31, 2000, the Bank's limit on loans to one borrower was $6.5 million. At December

31, 2000, the Bank's largest aggregate outstanding balance of loans to one borrower totaled approximately $16.5 million. This position arose as the result of a credit guarantee by a seller / servicer of a pool of residential mortgages, as more fully detailed under "Credit Quality - Special Residential Loan Pool" and Note 15 to the Consolidated Financial Statements.

Limitations On Capital Distributions

OTS regulations impose limitations upon all capital distributions by savings institutions, such as cash dividends, payments to repurchase or otherwise acquire its shares, payments to shareholders of another institution in a cash-out merger, and other distributions charged against capital.

The OTS recently adopted an amendment to these capital distribution limitations. Under the new rule, a savings association in some circumstances may:

- be required to file an application and await approval from the OTS before it makes a capital distribution
- be required to file a notice 30 days before the capital distribution
- be permitted to make the capital distribution without notice or application to the OTS

The OTS regulations require a savings association to file an application if:

- it is not eligible for expedited treatment of its other applications under OTS regulations
- the total amount of all of capital distributions, including the proposed capital distribution, for the applicable calendar year exceeds its net income for that year to date plus retained net income for the preceding two years
- it would not be at least adequately capitalized, under the prompt corrective action regulations of the OTS following the distribution
- the association's proposed capital distribution would violate a prohibition contained in any applicable statute, regulation, or agreement between the savings association and the OTS, or the FDIC, or violate a condition imposed on the savings association in an OTS-approved application or notice

In addition, a savings association must give the OTS notice of a capital distribution if the savings association is not required to file an application, but:

- would not be well capitalized under the prompt corrective action regulations of the OTS following the distribution
- the proposed capital distribution would reduce the amount of or retire any part of the savings association's common or preferred stock or retire any part of debt instruments like notes or debentures included in capital, other than regular payments required under a debt instrument approved by the OTS
- the savings association is a subsidiary of a savings and loan holding company (applicable to the Bank)

If neither the savings association nor the proposed capital distribution meet any of the above listed criteria, the OTS does not require the savings association to submit an application or give notice when making the proposed capital distribution. The OTS may prohibit a proposed capital distribution that would otherwise be permitted if the OTS determines that the distribution would constitute an unsafe or unsound practice. Further, a federal savings association, like the Bank, cannot distribute regulatory capital that is needed for its liquidation account.

Activities of Subsidiaries

A savings association seeking to establish a new subsidiary, acquire control of an existing company or conduct a new activity through a subsidiary must provide 30 days prior notice to the FDIC and the OTS and conduct any activities of the subsidiary in compliance with regulations and orders of the OTS. The OTS has the power to require a savings association to divest any subsidiary or terminate any activity conducted by a subsidiary that the OTS determines to pose a serious threat to the financial safety, soundness, or stability of the savings association or to be otherwise inconsistent with sound banking practices.

Liquidity

Federal regulations currently require thrift institutions to maintain an average daily balance of liquid assets (including cash, certain cash equivalents, certain mortgage-related securities, certain mortgage loans with the security of a first lien on residential property, and specified US Government, state, and federal agency obligations) equal to at least 4.0% of either (i) the average daily balance of its net withdrawable accounts plus short term borrowings (the "liquidity base") during the preceding calendar quarter, or (ii) the amount of the liquidity base at the end of the preceding calendar quarter. This liquidity requirement may be changed from time to time by the OTS to an amount within a range of 4.0% to 10.0% of such accounts and borrowings depending upon economic conditions and the deposit flows of thrift institutions. In addition, the Bank must comply with a general non-quantitative requirement to maintain a safe and sound level of liquidity. Throughout 2000, the regulatory liquidity ratio of the Bank exceeded regulatory requirements.

Restrictions On Investments And Loans

In addition to those restrictions presented above in reference to Liquidity and QTL Test requirements of federal thrift institutions, OTS regulations do not permit the Bank to invest directly in equity securities (with certain very limited exceptions), non investment grade debt securities, or real estate, other than real estate used for the institution's offices and facilities. Indirect equity investment in real estate through a subsidiary, such as Portola, is permissible, but is subject to certain limitations and deductions from regulatory capital. The Company's management has no plans to pursue real estate development or investment activity through Portola.

The OTS and other federal banking agencies have jointly adopted uniform rules on real estate lending and related Interagency Guidelines for Real Estate Lending Policies (the "Guidelines"). The uniform rules require that institutions adopt and maintain comprehensive written policies for real estate lending. The policies must reflect consideration of the Guidelines and must address relevant lending procedures, such as loan to value limitations, loan administration procedures, portfolio diversification standards and documentation, and approval and reporting requirements. Although the uniform rules do not impose specific maximum loan to value ratios, the related Guidelines state that such ratio limits established by an individual institution's board of directors generally should not exceed levels set forth in the Guidelines, which range from a maximum of 65% for loans secured by unimproved land to 85% for improved property. No limit is set for single family residential mortgages, but the Guidelines state that such loans equal to or exceeding a 90.0% loan to value ratio should have private mortgage insurance or some other form of credit enhancement. The Guidelines further permit a limited amount of loans that do not conform to these criteria.

Aggregate loans secured by non residential real property are generally limited to 400% of a thrift institution's total capital, as defined.

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Classification Of Assets

Thrift institutions are required to classify their assets on a regular basis, to establish appropriate allowances for losses, and to report the results of such classifications quarterly to the OTS. A thrift institution is also required to set aside adequate valuation allowances, and to establish liabilities for off balance sheet items, such as letters of credit, when loss becomes probable and estimable. The OTS has the authority to review the institution's classification of its assets and to determine whether and to what extent (i) additional assets must be classified, and (ii) whether the institution's allowances must be increased. Such instruction by the OTS to increase valuation allowances could have a material impact upon both the Bank's reported earnings and its financial condition.

Current or potential problem assets are segregated into one of four categories:

Category	Description
Special Mention	These assets, also called "criticized assets", present weaknesses or deficiencies deserving continued monitoring and heightened management attention.
Substandard	These assets, or portions thereof, possess well defined weaknesses which could jeopardize the timely liquidation of the asset or the realization of the collateral at values at least equal to the Company's investment in the asset. These assets are therefore characterized by the possibility that the institution will sustain some loss if the deficiencies or weaknesses are not corrected. Prudent general valuation and specific valuation allowances, as applicable, are required to be established for such assets. The Company classifies all real estate acquired through foreclosure as substandard.
Doubtful	These assets, or portions thereof, present probable loss of principal, but the amount of loss, if any, is subject to the outcome of future events which are not fully determinable at the time of classification. The Company allocates specific reserves against all assets classified as doubtful.
Loss	These assets, or portions thereof, present quantified losses to the institution. These assets are considered uncollectible and of such little

value that their continuance as bankable assets is not warranted. The institution must either establish a specific reserve equal to the institution's investment in the asset or charge off the asset.

The OTS and the other federal banking regulatory agencies have adopted an interagency policy statement regarding the appropriate levels of general valuation allowances for loan and lease losses that insured depository institutions should maintain. Under this policy statement, examiners will generally accept management's evaluation of the adequacy of general valuation allowances if the institution has:

- maintained effective systems and controls for identifying and addressing asset quality problems
- analyzed in a reasonable manner all significant factors that affect the collectibility of the portfolio
- established an acceptable process for evaluating the adequacy of general valuation allowances

However, the policy statement also provides that OTS examiners will review management's analysis more closely if general valuation allowances do not at least equal the following benchmarks:

- 15% of assets classified as substandard
- 50% of assets classified as doubtful
- for the portfolio of unclassified loans and leases, an estimate of credit losses over the upcoming twelve months based upon the institution's recent average rate of net charge-offs on similar loans, adjusted for current trends and conditions

The Company's internal credit policy is to comply with the interagency policy statement and to maintain adequate reserves for estimable losses. However, the determination of estimable losses is by nature an uncertain practice, and hence no assurance can be given that the Company's loss allowances will prove adequate to cover future losses.

Assessments

Thrift institutions are required to pay assessments to the OTS to fund the agency's operations. The general assessment, paid on a semi-annual basis, is computed based upon a three component equation. The components are total assets, regulatory rating, and amount and nature of off balance sheet activities. The Bank's general assessment for the six month period commencing January 1, 2001 was $63 thousand. The general assessments paid by the Bank for the fiscal year ended December 31, 2000 totaled $94 thousand.

Federal Home Loan Bank ("FHLB") System

The FHLB provides a comprehensive credit facility to member institutions. As a member of the FHLB-San Francisco, the Bank is required to own capital stock in an amount at least equal to the greater of:

- 1.0% of the aggregate principal amount of outstanding residential loans, as defined, at the beginning of each calendar year o 5.0% of its advances from the FHLB

At its most recent evaluation, the Bank was in compliance with this requirement. FHLB advances must be secured by specific types of collateral, including various types of mortgage loans and securities, and the Bank's investment in the capital stock of the FHLB. It is the policy of the Bank to maintain an excess of pledged collateral with the FHLB at all times to serve as a ready source of additional liquidity.

The FHLB's are required to provide funds to contribute toward the payment of certain bonds issued in the past to fund the resolution of insolvent thrifts. In addition, FHLB's are required by statute to contribute funds toward affordable housing programs. These requirements could reduce the amount of dividends the FHLB's pay on their capital stock and could also negatively impact the pricing offered for on and off balance sheet credit products - events which could unfavorably impact the profitability of the Company.

Recent federal legislation has addressed capital requirements for the Federal Home Loan Bank System. Each Federal Home Loan Bank is to develop its own capital plan, including what types of stock it may issue. At December 31, 2000, the FHLB-SF was in the process of determining its capital plan. Alternatives being discussed included the issuance of more than one class of stock, with the different classes possibly having various rights and restrictions. The Company cannot predict what the final capital plan of the FHLB-SF might be, or what impact such might have on the Company's investment in the capital stock of the FHLB or on the Bank's access to and utilization of FHLB financial services.

Federal Reserve System

The Federal Reserve Board ("FRB") requires insured depository institutions to maintain non-interest-earning ("sterile") reserves against certain of their transactional accounts (primarily deposit accounts that may be accessed by writing unlimited checks). At December 31, 2000, the regulations generally required that reserves be maintained against qualified net transaction accounts as follows:

First $5.5 million	Exempt
Next $37.3 million	3.0%
Above $42.8 million	10.0%

The reserve requirement may be met by certain qualified cash balances. The balances maintained to meet the reserve requirements of the FRB may be used to satisfy OTS liquidity requirements. For the calculation period including December 31, 2000, the Bank was in compliance with its FRB reserve requirements.

As a creditor and an insured depository institution, the Bank is subject to certain regulations promulgated by the FRB, including, but not limited to:

Regulation B	Equal Credit Opportunity Act
Regulation C	Home Mortgage Disclosure Act
Regulation D	Reserves
Regulation E	Electronic Funds Transfers Act
Regulation F	Limits On Interbank Liabilities
Regulation Z	Truth In Lending Act
Regulation X	Real Estate Settlement Procedures Act
Regulation CC	Expedited Funds Availability Act
Regulation DD	Truth In Savings Act

Potential Federal Legislation and Regulation

The US Congress continues to consider a broad range of legislative initiatives that might impact the financial services industry. Among these initiatives are:

- o the potential merger of the BIF and SAIF insurance funds of the FDIC
- o potential FDIC deposit insurance reforms, including an increase in the amount of coverage, changes in coverage for municipal deposits, and modifications in the assessment formula for FDIC insurance
- o the potential for insured depository institutions to pay interest on business checking deposits, perhaps in conjunction with authorization for the Federal Reserve to pay interest on sterile reserves
- o the potential relaxation of transaction count restrictions on money market demand deposits, thereby facilitating internal fund "sweeps" (of particular benefit to smaller financial institutions such as the Bank)
- o possible modifications in federal bankruptcy laws, including potential revisions that would encourage Chapter 13 filings (with payment requirements) versus Chapter 7 filings (debt forgiveness)

The Company cannot predict what legislation and regulation, if any, might emerge from Congress and the various federal regulatory agencies, and the potential impact of such legislation and regulation upon the Company.

Environmental Regulation

The Company's business and properties are subject to federal and state laws and regulations governing environmental matters, including the regulation of hazardous substances and wastes. For example, under the federal Comprehensive Environmental Response, Compensation, and Liability Act ("CERCLA") and similar state laws, owners and operators of contaminated properties may be liable for the costs of cleaning up hazardous substances without regard to whether such persons actually caused the contamination. Such laws may affect the Company as an owner or operator of properties used in its business, and through the Bank, as a secured lender of property that is found to contain hazardous substances or wastes.

Although CERCLA and similar state laws generally exempt holders of security interests, the exemption may not be available if a secured party engages in the management of its borrower or the securing property in a manner deemed beyond the protection of the secured party's interest. Recent federal and state legislation, as well as guidance issued by the United State Environmental Protection Agency and a number of court decisions, have provided assurance to lenders regarding the activities they may undertake and remain within CERCLA's secured party exemption. However, these assurances are not absolute and generally will not protect a lender or fiduciary that participates or otherwise involves itself in the management of its borrower, particularly in foreclosure proceedings. As a result, CERCLA and similar state statutes may influence the Bank's decision whether to foreclose on property that may be or is found to be contaminated. The Bank has adopted environmental underwriting requirements for commercial and industrial real estate loans. The Bank's general policy is to obtain an environmental assessment prior to foreclosure on commercial and industrial real estate. See "Business - General" and "Lending Activities - Loan

Portfolio Composition" regarding the recent and rapid expansion in the Bank's commercial and industrial real estate loan portfolio. The existence of hazardous substances or wastes on commercial and industrial real estate properties could cause the Bank to elect not to foreclose on the property, thereby limiting, and in some cases precluding, the Bank from realizing on the related loan. Should the Bank foreclose on property containing hazardous substances or wastes, the Bank would become subject to other environmental statutes, regulations, and common law relating to matters such as, but not limited to, asbestos abatement, lead-based paint abatement, hazardous substance investigation and remediation, air emissions, wastewater discharges, hazardous waste management, and third party claims for personal injury and property damage.

Federal Securities Laws

The Company's common stock is registered with the SEC under Section 12(g) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). The Company is subject to periodic reporting requirements, proxy solicitation rules, insider trading restrictions, tender offer rules, and other requirements under the Exchange Act. In addition, certain activities of the Company, its executive officers, and directors are covered under the Securities Act of 1933, as amended (the "Securities Act").

Non-Banking Regulation

The Company is impacted by many other laws and regulations, not necessarily unique to insured depository institutions. Among these other laws and regulations are federal bankruptcy laws.

Federal Taxation

General. The Bank and the Company report their income on a consolidated basis using the accrual method of accounting and will be subject to federal income taxation in the same manner as other corporations with some exceptions, including particularly the Bank's reserve for bad debts discussed below. The following discussion of tax matters is intended only as a summary and does not purport to be a comprehensive description of the tax rules applicable to the Bank or the Company. The Bank has not been audited by the IRS during the last five years. For its 2000 taxable year, the Bank is subject to a maximum federal income tax rate of 35%.

Bad Debt Reserve. For fiscal years beginning prior to December 31, 1995, thrift institutions which qualified under certain definitional tests and other conditions of the Internal Revenue Code of 1986 (the "Code") were permitted to use certain favorable provisions to calculate their deductions from taxable income for annual additions to their bad debt reserve. A reserve could be established for bad debts on qualifying real property loans (generally secured by interests in real property improved or to be improved) under (i) the Percentage of Taxable Income Method (the "PTI Method") or (ii) the Experience Method. The reserve for nonqualifying loans was computed using the Experience Method.

The Small Business Job Protection Act of 1996 (the "1996 Act"), which was enacted on August 20, 1996, requires savings institutions to recapture (i.e., take into income) certain portions of their accumulated bad debt reserves. The 1996 Act repeals the reserve method of accounting for bad debts effective for tax years beginning after 1995. Thrift institutions that would be treated as small banks are allowed to utilize the Experience Method applicable to such institutions, while thrift institutions that are treated as large banks (those generally exceeding $500 million in assets) are required to use only the specific charge-off method. Thus, the PTI Method of accounting for bad debts is no longer available for any financial institution.

A thrift institution required to change its method of computing reserves for bad debts will treat such change as a change in method of accounting, initiated by the taxpayer, and having been made with the consent of the IRS. Any Section 481 (a) adjustment required to be taken into income with respect to such change generally will be taken into income ratably over a six-taxable year period, beginning with the first taxable year beginning after 1995, subject to the residential loan requirement.

Under the residential loan requirement provision, the recapture required by the 1996 Act will be suspended for each of two successive taxable years, beginning with the Bank's current taxable year, in which the Bank originates a minimum of certain residential loans based upon the average of the principal amounts of such loans made by the Bank during its six taxable years preceding its current taxable year.

Under the 1996 Act, for its current and future taxable years, the Bank is permitted to make additions to its tax bad debt reserves. In addition, the Bank is required to recapture (i.e., take into income) over a six year period the excess of the balance of its tax bad debt reserves as of December 31, 1995 over the balance of such reserves as of December 31, 1987.

Distributions. Under the 1996 Act, if the Bank makes "non-dividend distributions" to the Company, such distributions will be considered to have been made from the Bank's unrecaptured tax bad debt reserves (including the balance of its reserves as of December 31, 1987) to the extent thereof, and then from the Bank's supplemental reserve for losses on loans, to the extent thereof, and an amount based on the amount distributed (but not in excess of the amount of such reserves) will be included in the Bank's income. Non-dividend distributions include distributions in excess of the Bank's current and accumulated earnings and profits, as calculated for federal income tax purposes, distributions in redemption of stock, and distributions in partial or complete liquidation. Dividends paid out of the Bank's current or accumulated earnings and profits will not be so included in the Bank's income.

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The amount of additional taxable income triggered by an non-dividend is an amount that, when reduced by the tax attributable to the income, is equal to the amount of the distribution. Thus, if the Bank makes a non-dividend distribution to the Company, approximately one and one-half times the amount of such distribution (but not in excess of the amount of such reserves) would be includable in income for federal income tax purposes, assuming a 35% federal corporate income tax rate. The Bank does not intend to pay dividends that would result in a recapture of any portion its bad debt reserves.

Corporate Alternative Minimum Tax. The Internal Revenue Code of 1986, as amended (the "Code") imposes a tax on alternative minimum taxable income ("AMTI") at a rate of 20%. The excess of the bad debt reserve deduction using the percentage of taxable income method over the deduction that would have been allowable under the experience method is treated as a preference item for purposes of computing the AMTI. Only 90% of AMTI can be offset by net operating loss carryovers of which the Bank currently has none. AMTI is increased by an amount equal to 75% of the amount by which the Bank's adjusted current earnings exceeds its AMTI (determined without regard to this preference and prior to reduction for net operating losses). In addition, for taxable years beginning after December 31, 1986 and before January 1, 1996, an environmental tax of 0.12% of the excess of AMTI (with certain modifications) over $2.0 million is imposed on corporations, including the Company, whether or not an Alternative

Minimum Tax ("AMT") is paid. The Bank does not expect to be subject to the AMT, but may be subject to the environmental tax liability.

Dividends Received Deduction and Other Matters. The Company may exclude from its income 100% of dividends received from the Bank as a member of the same affiliated group of corporations. The corporate dividends received deduction is generally 70% in the case of dividends received from unaffiliated corporations with which the Company and the Bank will not file a consolidated tax return, except that if the Company or the Bank own more than 20% of the stock of a corporation distributing a dividend then 80% of any dividends received may be deducted.

State and Local Taxation

State of California. The California franchise tax rate applicable to the Bank equals the franchise tax rate applicable to corporations generally, plus an "in lieu" rate approximately equal to personal property taxes and business license taxes paid by such corporations (but not generally paid by banks or financial corporations such as the Bank); however, the total tax rate cannot exceed 10.84%. Under California regulations, bad debt deductions are available in computing California franchise taxes using a three or six year weighted average loss experience method. The Bank and its California subsidiary file California State franchise tax returns on a combined basis. The Company, as a savings and loan holding company commercially domiciled in California, is treated as a financial corporation and subject to the general corporate tax rate plus the "in lieu" rate as discussed previously for the Bank.

Please refer to Note 14 to the Consolidated Financial Statements for additional information regarding income taxes.

Delaware Taxation. As a Delaware holding company not earning income in Delaware, the Company is exempted from Delaware corporate income tax but is required to file an annual report with and pay an annual franchise tax to the State of Delaware.

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Additional Item. Executive Officers of the Registrant

The following table sets forth certain information with respect to each executive officer of the Company or Bank who is not also a director of the Company. The Board of Directors appoints or reaffirms the appointment of all of the Company's executive officers each year. Each executive officer serves until the following year or until a respective successor is appointed.

Name	Age At 12/31/00	Position(s) With Company And / or Bank	Date Started In Position	Previous Experience Than Five Years In C
Carlene F. Anderson	48	Assistant Corporate Secretary Monterey Bay Bancorp, Inc.	6/11/99	Corporate Secretary, Bancorp, Inc. 1994 - 1999
		Assistant Corporate Secretary	6/11/99	Corporate Secretary,
		Vice President, Compliance Monterey Bay Bank.	8/15/98	1994 - 1999
Mark R. Andino	41	Chief Financial Officer	1/26/00	Treasurer, Chela Fin

		Treasurer Monterey Bay Bancorp, Inc.		Senior Vice Presiden Officer HF Bancorp, Inc., He 1999
		Senior Vice President Chief Financial Officer Treasurer Monterey Bay Bank	1/26/00	
Victor F. Davis	45	Controller Monterey Bay Bancorp, Inc.	11/21/00	Senior Vice Presiden Chief Financial Offi San Benito Bank
		Controller Monterey Bay Bank	8/1/00	1990 - 2000
Karen A. Flores	57	Assistant Corporate Secretary Monterey Bay Bancorp, Inc.	3/22/01	Branch Operations Sp Monterey Bay Bank 1996 - 2001
		Assistant Corporate Secretary	3/22/01	
		Branch Operations Specialist Monterey Bay Bank	9/1/96	
Susan F. Grill	48	Senior Vice President Director of Retail Banking Monterey Bay Bank	2/12/01	Personal Banking Exe Region Executive Centura Bank, 1998 -
		President Portola Investment Corporation	2/12/01	
David E. Porter	51	Senior Vice President Director of Commercial Banking Monterey Bay Bank	10/30/00	Executive Vice Presi Chief Credit Officer Southern Pacific Ban 1996 - 2000
Ben A. Tinkey	48	Senior Vice President Chief Loan Officer Monterey Bay Bank	9/20/94	

Item 2. Properties.

The following table sets forth information relating to each of the Company's offices as of December 31, 2000:

Location	Lease Or Owned	Original Date Leased or Acquired	Date of Lease Expiration

Administrative Offices:			
15 Brennan Street Watsonville, California 95076	Owned	12-31-65	N/A
567 Auto Center Drive Watsonville, California 95076	Owned	03-23-98	N/A
Branch Offices:			
35 East Lake Avenue Watsonville, California 95076	Owned	12-31-65	N/A
805 First Street Gilroy, California 95020	Owned	12-01-76	N/A
1400 Munras Avenue Monterey, California 93940	Owned	07-07-93	N/A
1890 North Main Street Salinas, California 93906	Owned	07-07-93	N/A
1127 South Main Street Salinas, California 93901	Leased	08-08-93	06-30-05
8071 San Miguel Canyon Road Prunedale, California 93907	Leased	12-24-93	12-24-03
601 Bay Avenue Capitola, California 95020	Owned	12-10-96	N/A
6265 Highway 9 Felton, California 95018	Leased	04-07-98	04-30-03

Item 3. Legal Proceedings.

From time to time, the Company is party to claims and legal proceedings in the ordinary course of business. Management believes that the ultimate aggregate liability represented thereby, if any, will not have a material adverse effect on the Company's consolidated financial position or results of operations, with the possible exception of the legal proceeding discussed in the subsequent paragraph.

During the third quarter of 2000, the Company established a $250 thousand accrual for a separation package associated with the former President & Chief Operating Officer, who resigned from the Company effective September 29, 2000. At December 31, 2000, the Company was still in the process of settling this matter, which is governed by employment contracts between Monterey Bay Bank and the individual and Monterey Bay Bancorp, Inc. and the individual. The governing employment contracts call for settlement exclusively by arbitration, which the Company was pursuing at December 31, 2000. Management believes its accrual reflects the Company's consolidated obligation and related direct costs under the associated contracts. A settlement payment consistent with the Company's aforementioned position was rejected during the fourth quarter of 2000. In November 2000, the former President & Chief Operating Officer filed suit in the Santa Cruz County Superior Court seeking an unspecified amount and the reinstatement of certain benefits. At December 31, 2000, the former President & Chief Operating Officer was pursuing a more substantial, though not clearly defined, settlement. The Santa Cruz County Superior Court directed the issue to be pursued through arbitration consistent with the employment contracts. The Company has retained specialists within its corporate law firm to represent it in this regard. Counsel has advised the Company that its position is reasonable.

Item 4. Submission of Matters to a Vote of Security Holders.

No matter was submitted during the quarter ended December 31, 2000 to a vote of Monterey Bay Bancorp, Inc.'s security holders through the solicitation of proxies or otherwise.

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PART II

Item 5. Market for Registrant's Common Equity and Related Stockholder Matters.

The Common Stock of Monterey Bay Bancorp, Inc. is traded over the counter on the National Association Of Securities Dealers Automated Quote ("NASDAQ") system under the symbol "MBBC." The stock commenced trading on February 15, 1995, when the Company went public and sold 4,492,085 shares at a price of $6.40 per share (adjusted for a 5:4 stock split on July 31, 1998).

As of March 6, 2001, there were 3,419,764 shares of the Company's common stock outstanding. As of February 28, 2001, there were 293 stockholders of record, not including persons or entities who hold their stock in nominee or "street" name.

The following table sets forth the high and the low daily closing prices of the Company's common stock for each of the following calendar quarters.

	High	Low
Year Ended December 31, 2000:		
Fourth quarter	$ 10.750	$ 9.125
Third quarter	$ 10.000	$ 8.250
Second quarter	$ 9.375	$ 7.813
First quarter	$ 10.625	$ 7.875
Year Ended December 31, 1999:		
Fourth quarter	$ 15.000	$ 9.375
Third quarter	$ 15.625	$ 10.500
Second quarter	$ 15.000	$ 10.000
First quarter	$ 14.750	$ 11.000

The board of directors declared, and the Company paid, cash dividends of $0.08 and $0.15 per share during the years ended December 31, 2000 and 1999, respectively. As previously announced, the Board of Directors has indefinitely suspended the declaration and payment of cash dividends.

The Company is subject to certain restrictions and limitations on the payment of dividends pursuant to existing and applicable laws and regulations (see "Item 1. Business - Regulation And Supervision - Limitation On Capital Distributions" and Note 15 to the Consolidated Financial Statements).

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Item 6. Selected Financial Data.

Set forth below are selected consolidated financial and other data of the Company for the periods and the dates indicated. This financial data is derived in part from, and should be read in conjunction with, the Consolidated Financial Statements and related Notes of the Company presented elsewhere herein. All per share information has been adjusted to reflect a five for four stock split paid to stockholders of record in July 1998.

	At December 31,		
	2000	1999	1998
	(Dollars In Thousand		
Selected Financial Condition Data:			
Total assets	$ 486,190	$ 462,827	$ 454,046
Investment securities available for sale	7,360	11,463	19,410
Investment securities held to maturity	--	--	--
Mortgage backed securities available for sale	42,950	57,716	98,006
Mortgage backed securities held to maturity	--	60	97
Loans receivable held for investment, net	391,820	360,686	298,775
Loans held for sale	--	--	2,177
Allowance for loan losses	5,364	3,502	2,780
Deposits	407,788	367,402	370,677
FHLB advances	32,582	49,582	35,182
Securities sold under agreements to repurchase	--	2,410	4,490
Stockholders' equity	43,837	40,803	41,116
Non-performing loans	4,741	8,182	2,915
Real estate acquired by foreclosure, net	--	96	281

	For The Year Ended Decembe		
	2000	1999	1998
	(Dollars In Thousands, Except S		
Selected Operating Data:			
Interest and dividend income	$ 37,757	$ 33,417	$ 30,911
Interest expense	19,777	17,388	18,588
Net interest income before provision for loan losses	17,980	16,029	12,323
Provision for loan losses	2,175	835	692
Net interest income after provision for loan losses	15,805	15,194	11,631
Non-interest income	2,340	2,505	2,177
Non-interest expense (1)	13,676	11,887	11,144
Income before provision for income taxes	4,469	5,812	2,664
Provision for income taxes	1,946	2,511	1,228
Net income	$ 2,523	$ 3,301	$ 1,436

Shares applicable to basic earnings per share	3,110,910	3,231,162	3,501,738
Basic earnings per share	$ 0.81	$ 1.02	$ 0.41
Shares applicable to diluted earnings per share	3,123,552	3,320,178	3,638,693
Diluted earnings per share	$ 0.81	$ 0.99	$ 0.39
Cash dividends per share	$ 0.08	$ 0.15	$ 0.12

	At Or For The Year Ended Dece		
	2000	1999	1998
Selected Financial Ratios and Other Data (2):			
Performance Ratios			
Return on average assets (3)	0.53%	0.73%	0.33%
Return on average stockholders' equity (4)	6.24%	8.05%	3.29%
Average stockholders' equity to average assets	8.52%	9.04%	10.06%
Stockholders' equity to total assets at end of period	9.02%	8.82%	9.06%
Interest rate spread during the period (5)	3.54%	3.27%	2.43%
Net interest margin (6)	3.96%	3.69%	2.96%
Interest rate margin on average total assets (7)	3.79%	3.53%	2.84%
Average interest-earning assets / average interest-bearing liabilities	109.62%	110.61%	112.00%
Non-interest expense / average total assets	2.88%	2.62%	2.57%
Efficiency ratio (8)	67.30%	64.14%	76.86%
Regulatory Capital Ratios (9)			
Tangible capital	8.03%	7.11%	6.53%
Core capital	8.03%	7.11%	6.53%
Total risk based capital	12.28%	10.56%	11.35%
Asset Quality Ratios			
Non-performing loans / gross loans receivable (10)	1.19%	2.25%	0.96%
Non-performing assets / total assets (11)	0.98%	1.79%	0.71%
Net charge-offs / average gross loans receivable	0.08%	0.03%	--
Allowance for loan losses / gross loans receivable (10)	1.35%	0.96%	0.92%
Allowance for loan losses / non-performing loans	113.14%	42.80%	95.37%
Allowance for total estimated losses / non-performing assets	113.14%	42.30%	87.15%
Other Data			
Number of full-service customer facilities	8	8	8
Number of deposit accounts	29,129	27,831	26,124
Number of ATM's	11	10	10

Item 7. Management's Discussion And Analysis Of Financial Condition And Results Of Operations.

The following discussion and analysis should be read in conjunction with the Company's Consolidated Financial Statements and Notes to the Consolidated Financial Statements presented elsewhere in this Annual Report. Certain matters discussed or incorporated by reference in this Annual Report including, but not limited to, matters described in this Item 7., are forward looking statements that are subject to risks and uncertainties that could cause actual results to differ materially from those projected or implied in such statements.

General

The Company's primary business is providing financial services to individuals and businesses. The Company is headquartered in Watsonville, California, along the Central Coast. The Bank's history dates back 75 years, over which time the Bank has built its customer base to exceed 29,000 deposit accounts.

The Company pursues its business through conveniently located branch offices, where it attracts checking, money market, savings, and certificate of deposit accounts. These deposits, and other available funds, are invested in a variety of loans and securities. The vast majority of the Company's loans at December 31, 2000 are secured by various types of real estate. The Bank's deposit gathering and lending markets are concentrated in the communities surrounding its eight full service branch offices located in Santa Cruz, northern Monterey, and southern Santa Clara Counties, in California. The Company also conducts its business by a variety of electronic means, including Internet banking, telephone banking, and automated teller machine ("ATM") networks.

The most significant component of the Company's revenue is net interest income. Net interest income is the difference between interest and dividend income, primarily from loans, mortgage backed securities, and investment securities, and interest expense, primarily on deposits and borrowings. The Company's net interest income and net interest margin, which is defined as net interest income as a percent of average interest-earning assets, are affected by its asset growth and quality, its asset and liability composition, and the general interest rate environment.

The Company's service charges on deposits, mortgage loan servicing fees, and commissions from the sale of non-FDIC insured insurance products and investments through Portola also have significant effects on the Company's results of operations. An additional major factor in determining the Company's results of operations are non-interest expenses, which consist primarily of employee compensation, occupancy and equipment expenses, data and item processing fees, and other operating expenses. The Company's results of operations are also significantly affected by the level of provisions for loan losses and general economic and competitive conditions, particularly absolute and relative levels and changes in market interest rates, government policies, and actions of regulatory agencies.

As discussed under "Item 1. Business - Business Strategy", the Company is in the process of transforming itself from a relatively traditional savings and loan association into a community based commercial bank. This transformation is being undertaken to enhance stockholder value while at the same time better meeting the financial needs of the individuals, families, professionals, and businesses in the Greater Monterey Bay Area of Central California.

Interest Rate Environment

The table below presents an overview of the interest rate environment during the two years ended December 31, 2000. In mid-1999, the Federal Reserve commenced what would become six consecutive interest rate increases totaling 175 basis points, concluding in May, 2000. These increases were implemented by the Federal Reserve in response to strong economic growth and tight labor markets, among other factors. The Federal Reserve did not adjust its benchmark interest rates (including the target rate for overnight federal funds) again until January, 2001. In January, 2001, the Federal Reserve decreased its benchmark rates by a total of 100 basis points, in response to concerns regarding a rapidly slowing economy and a sharp decline in manufacturing activity, among other factors.

While the Federal Reserve took no formal rate adjustment action between June 2000 and December 2000, the capital markets did reflect the changing economic environment. Many capital markets interest rates, such as the London InterBank Offer Rate ("LIBOR") curve, peaked about May, 2000, and then commenced a gradual decline throughout the remainder of the year. For example, the one year LIBOR rate at May 31, 2000 was 7.50%, declining to 6.00% by December 31, 2000.

The Treasury yield curve shifted from a more traditional positively sloped curve at the beginning of 2000 to significantly negatively sloped curve by the end of the year. Inverted yield curves often present challenges to financial institutions, as short term funding rates can be higher than longer term investment rates.

Yields on longer term Treasuries over the past two years have been influenced by both the general economic and interest rate environment, and the federal budget surplus. The federal budget surpluses have allowed the US government to repurchase longer term Treasury securities in the open markets, increasing demand and therefore also supporting higher prices and lower effective yields.

The 11th District Cost Of Funds Index ("COFI") is by nature a lagging index that trails changes in more responsive interest rate indices such as those associated with the Treasury or LIBOR markets.

Index/ Rate	12/31/98	3/31/99	6/30/99	9/30/99	12/31/99	3/31/00	6/30/00
3 month Treasury bill	4.46%	4.47%	4.76%	4.85%	5.31%	5.87%	5.85%
6 month Treasury bill	4.54%	4.51%	5.03%	4.95%	5.73%	6.14%	6.22%
1 year Treasury bill	4.52%	4.71%	5.05%	5.17%	5.96%	6.23%	6.05%
2 year Treasury note	4.53%	4.98%	5.52%	5.59%	6.24%	6.47%	6.36%
5 year Treasury note	4.54%	5.10%	5.65%	5.75%	6.34%	6.31%	6.18%
10 year Treasury note	4.65%	5.24%	5.78%	5.88%	6.44%	6.00%	6.03%
30 year Treasury bond	5.09%	5.62%	5.97%	6.05%	6.48%	5.83%	5.90%
Target federal funds	4.75%	4.75%	5.00%	5.25%	5.50%	6.00%	6.50%
Prime rate	7.75%	7.75%	7.75%	8.25%	8.50%	9.00%	9.50%
COFI	4.66%	4.52%	4.50%	4.61%	4.85%	5.00%	5.36%

Business Strategy

During 2000, the Company achieved progress in its business strategy of transforming a 75 year old savings and loan into an effective community based financial services company. Elements of this business strategy include:

o Increasing the Company's ratio of loans to deposits as a means of enhancing net interest income, serving more customers, moderating exposure to change in general market interest rates, and better utilizing the Company's capital resources.

o Diversifying the product mix within the loan portfolio to reduce the historic high concentration in relatively commoditized residential mortgages while also meeting the financing needs of consumers and small businesses within the Company's market areas.

o Enhancing the Company's delivery of relationship banking, where the Company's employees invest time and resources in thoroughly understanding their customers and thereby provide a comprehensive financial services solution

o Expanding services for businesses, including improved deposit courier service and cash management products.

o Acquiring customers disaffected by the acquisition of their financial services provider.

o Capitalizing on the Company's position as one of the largest independent financial institutions in the Greater Monterey Bay Area.

o Bolstering non-interest income from an expanding list of fee based products and services, including ATM surcharges, deposit account and branch service charges, and sales of non-FDIC insured investment products including mutual funds and annuities.

o Changing the Company's deposit mix to emphasize transaction accounts as a means of cementing customer relationships, lowering the Company's relative cost of funds, generating fee income, and increasing the duration of the Company's funding.

o Capitalizing on business opportunities unique to the Company's primary service areas; for example, installing remote ATM's at highly trafficked tourist attractions.

o Pursuing alternative forms of delivery for financial products and services as a means of attracting a greater volume of business while also improving the Company's efficiency ratio.

o Installing new technologies that support a greater range of financial products and services while at the same time increasing the speed, accuracy, and efficiency of the Company's operations.

The Company intends to continue pursuing this business strategy in 2001, with specific goals of installing a more modern and technologically robust core processing system, expanding the recently formed Commercial Banking and Professional Banking groups, offering bilingual telephone banking, increasing customer use of Internet banking and electronic bill payment, pursuing additional remote ATM sites, and expanding the Company's market coverage through either additional traditional, full service branches or other alternatives, possibly including supermarket banking. However, there can be no assurance that any such steps will be implemented, or if implemented, whether such steps will improve the Company's financial performance.

Analysis Of Results Of Operations For The Years Ended December 31, 2000 And December 31, 1999

Overview

The Company reported net income of $2.5 million for the year ended December 31, 2000, down from net income of $3.3 million realized during the prior year. These amounts translate to $0.81 basic and diluted earnings per share in 2000, compared to $1.02 basic and $0.99 diluted earnings per share in 1999. The Company's return on average assets decreased from 0.73% in 1999 to 0.53% in 2000. The Company's average return on equity also fell, from 8.05% in 1999 to 6.24% in 2000. The overall reduction in net income during 2000 resulted from a number of factors, including a higher provision for loan losses, greater operating expenses, and less favorable results from the sale of securities. These factors more than offset increases in net interest income and most sources of non-interest income other than results from the sale of securities.

Net Interest Income

During the years ended December 31, 2000, 1999, and 1998, net interest income before the provision for loan losses was $18.0 million, $16.0 million, and $12.3 million, respectively. The level of average interest-earning assets over the same years was $454.1 million, $434.8 million, and $416.2 million, respectively. The net interest spread was 3.54%, 3.27%, and 2.43%, respectively, for the years ended December 31, 2000, 1999, and 1998. During these same periods, the ratio of net interest income to average total assets was 3.79%, 3.53%, and 2.84%, respectively.

The $2.0 million, or 12.2%, increase in net interest income generated in 2000 versus the prior year was primarily produced by three key changes in the Company's balance sheet composition:

1. On the asset side of the balance sheet, the Company redirected its earning asset mix towards loans receivable, reducing the proportion of earning assets comprised of relatively lower yielding cash equivalents, investment securities, and mortgage backed securities. Loans receivable, net, increased from 78.0% of average interest earning assets in 1999 to 83.6% of average interest earning assets in 2000. Loans receivable, net, earned a weighted average rate of 8.57% during 2000, comparing favorably to 6.33% on cash equivalents, 7.73% on investment securities, and 6.98% on mortgage backed securities.

2. On the liability side of the balance sheet, the Company increased the percentage of average interest bearing liabilities composed of transaction deposit accounts (NOW, savings, and money market) from 31.2% in 1999 to 33.8% in 2000. Transaction deposit accounts present a relatively lower cost of funding than most alternative sources. The proportional increase in average transaction accounts was offset by a decline in the percentage of average interest bearing liabilities represented by certificates of deposit. Certificates of deposit represented 55.5% of average interest bearing liabilities in 2000, versus 58.4% the prior year.

3. The Company increased its average balance of interest earning assets by

$19.3 million, or 4.4%, in 2000 versus 1999. Due to the deposit growth the Company achieved during 2000, this rise in average interest earning assets was accomplished with only a slight increase in the proportion of funding provided by comparatively higher cost borrowings. Borrowings as a percentage of average interest bearing liabilities increased from 10.4% in 1999 to 10.7% in 2000. The Company's larger average balance sheet in 2000 versus 1999 contributed to the $2.0 million rise in net interest income.

In conjunction with its business strategy, the Company intends to continue its pursuit of nominal and proportional increases in average non-interest bearing liabilities (primarily demand deposit accounts) during 2001 through a combination of enhanced marketing to businesses, redesigned checking products following the planned systems conversion, and expanded business services such as various types of lines of credit and courier deposit collection. Average non-interest bearing liabilities increased from $19.4 million during 1999 to $19.8 million during 2000. An increase in average non-interest bearing liabilities would favorably impact the Company's net interest income.

Average Balances, Average Rates, And Net Interest Margin

The following table presents the average amounts outstanding for the major categories of the Company's assets and liabilities, the average rate earned upon each major category of interest earning assets, the average rate paid for each major category of interest bearing liabilities, and the resulting net interest spread, net interest margin, and average interest margin on total assets for the years indicated.

	Year Ended December 31, 2000			Year Ended December 31, 1999			Ye
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate	Av Ba
Assets				(Dollars In Thousands)			
Interest earning assets:							
Cash equivalents (1)	$ 8,533	$ 540	6.33%	$ 5,837	$ 280	4.80%	$1
Investment securities (2)	8,915	689	7.73%	13,620	871	6.40%	3
Mortgage backed securities(3)	53,822	3,755	6.98%	73,122	4,884	6.68%	10
Loans receivable, net (4)	379,823	32,556	8.57%	339,036	27,218	8.03%	25
FHLB stock	3,003	217	7.23%	3,139	164	5.22%	
Total interest earning assets	454,096	37,757	8.31%	434,754	33,417	7.69%	41
Non-interest earnings assets	20,391			18,691			1
Total assets	$474,487			$453,445			$4
Liabilities & Equity							
Interest bearing liabilities:							
NOW accounts	$36,317	550	1.51%	$25,205	388	1.54%	1

Savings accounts	15,803	281	1.78%	15,583	280	1.80%	1
Money market accounts	87,733	4,040	4.60%	82,006	3,402	4.15%	4
Certificates of deposit	230,099	12,360	5.37%	229,493	11,060	4.82%	26
Total interest-bearing deposits	369,952	17,231	4.66%	352,287	15,130	4.29%	33
FHLB advances	43,946	2,514	5.72%	37,600	2,078	5.53%	2
Other borrowings (5)	359	32	8.91%	3,182	180	5.65%	
Total interest-bearing liabilities	414,257	19,777	4.77%	393,069	17,388	4.42%	37
Non-interest bearing liabilities	19,824			19,386			1
Total liabilities	434,081			412,455			39
Stockholders' equity	40,406			40,990			4
Total liabilities & equity	$474,487			$453,445			$4
Net interest income		$ 17,980			$ 16,029		
Interest rate spread (6)			3.54%			3.27%	
Net interest earning assets	39,839			41,685			4
Net interest margin (7)		3.96%			3.69%		
Net interest income / average total assets		3.79%			3.53%		
Interest earnings assets / interest bearing liabilities	1.10			1.11			

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Rate/Volume Analysis

The most significant impact on the Company's net interest income between periods is derived from the interaction of changes in the volumes of and rates earned or paid on interest-earning assets and interest-bearing liabilities. The following table utilizes the figures from the preceding table to present a comparison of interest income and interest expense resulting from changes in the volumes and the rates on average interest earning assets and average interest bearing liabilities for the years indicated. Changes in interest income or interest expense attributable to volume changes are calculated by multiplying the change in volume by the prior year average interest rate. The changes in interest income or interest expense attributable to interest rate changes are calculated by multiplying the change in interest rate by the prior year average volume. The changes in interest income or interest expense attributable to the combined impact of changes in volume and changes in interest rate are calculated by multiplying the change in rate by the change in volume.

	Year Ended December 31, 2000 Compared To Year Ended December 31, 1999				Year Ended Decem Compared Year Ended Decem	
	Increase (Decrease) Due To				Increase (Decre	
	Volume	Rate	Volume / Rate	Net	Volume	Rate
	(Dollars In Thousands)					
Interest-earning assets						
Cash equivalents	$ 129	$ 89	$ 42	$ 260	$ (264)	$ (61)
Investment securities	(301)	182	(63)	(182)	(1,484)	55
Mortgage backed securities	(1,289)	218	(58)	(1,129)	(2,108)	118
Loans receivable, net	3,274	1,842	222	5,338	6,415	(56)
FHLB Stock	(7)	63	(3)	53	(22)	(22)
Total interest-earning assets	1,806	2,394	140	4,340	2,537	34
Interest-bearing liabilities						
NOW Accounts	171	(6)	(3)	162	167	(3)
Savings accounts	4	(3)	--	1	7	(5)
Money market accounts	238	374	26	638	1,587	52
Certificates of deposit	29	1,267	4	1,300	(1,988)	(1,575)
Total interest-bearing deposits	442	1,632	27	2,101	(227)	(1,531)
FHLB advances	351	73	12	436	565	(111)
Other borrowings	(159)	104	(93)	(148)	(108)	(14)
Total interest-bearing liabilities	634	1,809	(54)	2,389	230	(1,656)
Increase (decrease) in net interest income	$1,172	$ 585	$ 194	$1,951	$2,307	$1,690

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Interest Income

Interest income for the year ended December 31, 2000 totaled $37.8 million, an increase of $4.3 million from the prior year. The increase resulted from a shift in asset mix toward higher yielding assets, the generally higher interest rate environment in 2000 versus 1999, a decision by the FHLB-SF to pay particularly high dividend rates during the first half of 2000 in conjunction with its capital management program, and a larger average balance of interest earning assets. The larger average balance of interest earning assets stemmed from the Company's desire to effectively utilize the Bank's regulatory capital and liquidity in building the size of the loan portfolio. The weighted average yield on interest earning assets increased from 7.69% during 1999 to 8.31%

during 2000. The yield on the Company's assets generally benefits from a higher interest rate environment, as the vast majority of the Company's assets are either adjustable rate or fixed rate with limited duration.

Interest income on loans increased 18.9% from $27.2 million in 1999 to $32.6 million in 2000. This rise was due to a greater average balance of loans outstanding and higher average rates. The higher average rates stemmed from both the higher general interest rate environment and the shift in loan mix away from relatively lower yielding residential mortgages and toward generally higher yielding multifamily and commercial real estate loans.

Interest income on mortgage backed securities decreased from $4.9 million in 1999 to $3.8 million in 2000, as the impact of lower average balances more than offset the effect of higher average rates. A similar pattern applied to interest income on investment securities, which decreased from $871 thousand in 1999 to $689 thousand in 2000. The average rate on the Company's investments in corporate trust preferred securities rose relatively rapidly during 2000 due to their repricing quarterly off the responsive three month LIBOR index. The increase in rate was, however, insufficient to offset the impact of lower average volumes resulting from the sale of corporate trust securities with a face value of $4.0 million during 2000.

Interest income on cash equivalents rose during 2000, as a greater average balance was complemented by higher average rates resulting from the increases in the target federal funds rate implemented by the Federal Reserve. The Company maintained a higher average balance of cash equivalents during 2000 primarily due to the periodic build up of excess liquidity in support of pending loan originations and purchases. In addition, during 2000, the Company placed $180 thousand in short term certificates of deposit with minority focused financial institutions in conjunction with its proactive program under the Community Reinvestment Act.

Interest Expense

Interest expense on deposits increased from $15.1 million during 1999 to $17.2 million during 2000 due to a combination of greater average balances and higher average rates. The greater average balances stemmed from the Company's deposit acquisition initiatives throughout the year to attract more consumer and business deposit accounts. These initiatives included holding 75th anniversary celebrations at each of the Company's facilities. Current and potential customers were invited to attend each of the events, at which management and directors highlighted the Bank's accomplishments and strengths, and solicited additional business. The average rate paid on deposits during 2000 increased from the prior year, despite a favorable shift in deposit mix, due to the higher general interest rate environment. The average cost of interest bearing deposits rose from 4.29% during 1999 to 4.66% during 2000.

Interest expense on borrowings increased from $2.3 million during 1999 to $2.5 million during 2000. Higher average volumes and greater average rates each contributed to the rise in interest expense. The Company primarily used FHLB advances as a source of borrowings during 2000, with MBBC far less active in selling securities under agreements to repurchase during 2000 versus prior years due to the sale of MBBC's security portfolio in early 2000.

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Provision For Loan Losses

Implicit in lending activities is the risk that losses will occur and that the amount of such losses will vary over time. Consequently, the Company maintains an allowance for loan losses by charging a provision to operations.

Loans determined to be losses are charged against the allowance for loan losses. The allowance for loan losses is maintained at a level considered by management, at a point in time and with then available information, to be adequate to provide for probable losses inherent in the existing portfolio.

In evaluating the adequacy of the allowance for loan losses, management estimates the amount of probable loss for each individual loan that has been identified as having greater than standard credit risk, including loans identified as criticized ("Special Mention"), classified ("Substandard" or lower graded), impaired, troubled debt restructured, and non-performing. In determining specific and general loss estimates, management incorporates such factors as collateral value, portfolio composition and concentration, trends in local and national economic and real estate conditions, the duration of the current business cycle, seasoning of the loan portfolio, historical credit experience, and the financial status of borrowers. While the general allowance is segmented by broad portfolio categories to analyze its adequacy, the allowance is general in nature and is available for the loan portfolio in its entirety. Although management believes that the allowance is adequate, future provisions are subject to continuing evaluation of inherent risk in the loan portfolio, as conducted by both management and the Bank's regulators.

Provision for loan losses increased from $835 thousand during 1999 to $2.2 million during 2000. This increase resulted from the following factors:

1. The growth in the size of the loan portfolio during 2000.

2. Net charge-offs of $313 thousand in 2000 versus $113 thousand in 1999.

3. The continued shift in loan mix away from residential mortgages and toward income property loans, which typically present more credit risk than residential mortgages.

4. Specific reserves rose from $200 thousand at December 31, 1999 to $600 thousand at December 31, 2000. The $600 thousand specific reserve at December 31, 2000 was associated with a $2.85 million commercial construction loan located in the Company's primary market area. At December 31, 2000, the Company was in the process of foreclosing on the subject collateral. The property's construction was substantially completed at December 31, 2000, but the borrower experienced difficulty in obtaining an occupancy permit from local government agencies primarily due to concerns regarding the traffic capacity of nearby roads.

5. The increasing credit concentrations in the Company's loan portfolio associated with a smaller number of comparatively larger income property loans versus a larger number of comparatively smaller residential mortgages

6. An increase in unallocated general reserves from $266 thousand at December 31, 1999 to $739 thousand at December 31, 2000. This increase in unallocated reserves resulted from management's concerns about several key factors which management believes have negatively impacted the inherent loss in the Company's credit portfolio, including:

    - the California energy crisis, with impacts upon the availability and price of electricity, business costs, consumer spending and disposable income, and the pace of economic activity in the State

    - the financial difficulties experienced by many technology related companies in the Silicon Valley area adjacent to the Bank's primary market areas

    - the impact of lower technology stock prices on consumer spending, liquidity, and investment, with a particular concern regarding effects on the demand and pricing for real estate in the Bank's primary market areas

- the general reduction in national economic growth and the increased volume of layoffs being announced by major corporations

To the extent that the Company is successful in its business strategy and thereby continues building the size of its loan portfolio while also extending increased volumes of construction, income property, and business lending, management anticipates that additional provisions will be required and charged against operations in 2001, with the ratio of allowance for loan losses to loans receivable increasing to reflect the greater credit exposure inherent in the loan mix.

Non-interest Income

Non-interest income declined from $2.5 million in 1999 to $2.3 million in 2000. This decrease was primarily due to less favorable results on the sale of securities more than offsetting increased non-interest income from most other components of the Company's fee based businesses.

The Company experienced a net pre-tax loss of $55 thousand on the sale of mortgage backed and investment securities during 2000, versus a gain of $496 thousand in 1999. The gains realized in 1999 occurred during the first half of that year, in a comparatively low general interest rate environment that increased the market value of the Company's securities.

Commissions from the sale of non-insured products rose from $626 thousand in 1999 to $676 thousand in 2000. The Company earns these commissions primarily on the sale of annuities and mutual funds to consumers in its primary market areas. The Company presently has four licensed account representatives that work for Portola and assist individuals with meeting their financial objectives through an investment program.

Customer service charges increased from $1.0 million during 1999 to $1.3 million during 2000 due to the growth in the customer base reflected in the increased number of transaction accounts combined with the implementation of a new fee & service charge schedule in mid 2000.

Income from loan servicing increased from $84 thousand in 1999 to $118 thousand in 2000. The Company anticipates that this source of income will decline in future periods, as the majority of the Company's loan sales now occur on a servicing released basis. During 2001, the Company may consider the sale of its Agency servicing portfolio.

Further augmenting non-interest income constitutes a primary component of the Company's business strategy. In 2001, the Company plans to enhance its revenues from the sale of non-FDIC insured investment products by reviewing third party contracts, considering the licensing of additional staff, and broadening its product line. For example, the Company is evaluating the possible securities licensing of its new Professional Banking Group members. In addition, a new non-FDIC insured product program manager was hired in February, 2001.

Also in 2001, the Company plans to augment customer service charges by adjusting the Bank's fee and service charge schedule, redesigning its checking products in conjunction with the planned systems conversion, continuing to market electronic bill payment and debit card services, further increasing the number of transaction accounts, and selling depository and cash management services to business customers who would be charged via account analysis. No assurance can, however, be provided that the Company will be successful in its plans to increase non-interest income.

Non-Interest Expense

Non-interest expense totaled $13.7 million in 2000, up $1.8 million from $11.9 million the prior year. Factors contributing to the rise in 2000 included:

1. Compensation and employee benefits increased from $5.6 million during 1999 to $6.6 million during 2000. This increase resulted from a number of factors, including:

   o The hiring of additional staff to support the Company's strategic plan, including the Bank's first experienced commercial loan officer.

   o Changes in the Company's senior management team.

   o The settlement of certain non-qualified benefits obligations.

   o A $250 thousand accrual for a separation package for the former President and Chief Operating Officer. This accrual was recorded in conjunction with the applicable employment agreements between the individual and the Company. At December 31, 2000, the Company was pursuing arbitration in this regard, as called for under the employment contracts.

   o The implementation of an expanded performance based incentive compensation program.

2. Data processing expense increased from $1.0 million in 1999 to $1.14 million in 2000 due to servicing a greater volume of loan and deposit accounts and processing a greater number of transactions, and because of costs associated with the planned data processing conversion. The greater number of accounts and transaction also led to increased spending on supplies, printing, and postage costs.

3. The payment of $108 thousand in expenses during the fourth quarter of 2000 in support of the planned data processing conversion. These expenses included costs for travel, training, deconversion services from the existing data processor, and consultants assisting with the technology implementation. The Company anticipates incurring an increased level of similar expenses during the first half of 2001 as the conversion project progresses.

4. Recruitment and relocation expenses for hiring new members of the Company's management team, including a new Chief Executive Officer, Chief Financial Officer, Controller, and Director of Commercial Lending.

5. The adoption of a Directors Emeritus program that provides cash recognition payments to retiring directors meeting certain eligibility requirements.

6. Higher outside professional costs. The Company incurred significant legal costs, in aggregate, during 2000 in conjunction with the successful collection of a $5.0 million non-performing loan, a review of charter alternatives, and addressing the potential settlement of claims by the former President & Chief Operating Officer. The Company also incurred higher accounting related costs in 2000 in conjunction with an expansion of

its co-sourced internal audit program.

Primarily because of the higher operating costs described above, the Company's average efficiency ratio for 2000 increased to 67.3%, up from 64.1% during 1999. The transformation of the Company has also contributed to increases in the efficiency ratio, as up front operating costs and other expenses must often be incurred prior to the realization of associated revenues as the Company changes its business mix and redirects its sales efforts.

The Company's new management team commenced a series of initiatives to improve the Company's efficiency ratio during the second half of 2000. These initiatives included:

o the replacement of certain vendors with more efficient and lower cost providers, particularly those that interface effectively via the Internet

o elimination of certain discretionary costs throughout the branch network

o changes to the Company's ongoing operations, such as the elimination of passbook based deposit accounts and the elimination of most monthly statements on certificates of deposit

o reallocating employee resources to areas providing a greater financial contribution

o increasing emphasis upon variable, performance based compensation

o the acquisition and installation of more efficient technology throughout the Company and the integration of that technology to speed operations and improve productivity and accuracy

However, due to the time required to conclude existing contractual obligations, implement these initiatives (including employee training), and conduct required customer notification, many of the above initiatives provided little economic benefit during 2000. The Company cannot predict whether the above initiatives will be successfully implemented, and if implemented, whether they will produce a sufficient benefit to offset other factors that might work to increase the efficiency ratio, including the implementation of the Company's strategic plan.

Provision For Income Taxes

The provision for income taxes decreased from $2.5 million during 1999 to $1.9 million during 2000 due to a reduction in pre-tax income. The Company's effective book tax rate increased slightly in 2000, in part due to the greater impact of non-deductible expenses and other tax related adjustments on a lower base of pre-tax income.

Comparison Of Financial Condition At December 31, 2000 And December 31, 1999

Total assets of the Company were $486.2 million at December 31, 2000, compared to $462.8 million at December 31, 1999, an increase of $23.4 million, or 5.0%.

Investment securities declined from $11.5 million at December 31, 1999 to $7.4 million at December 31, 2000 due to the sale of a corporate trust preferred security during 2000 in order to generate funding for the Company's increasing loan portfolio. The Company's investment security portfolio at December 31, 2000 was composed of two variable rate, quarterly repricing, corporate trust preferred securities issued by major US banks. These two securities were rated "A-" or better by Standard & Poors rating agency at December 31, 2000. Management may consider selling these two securities in 2001 in order to bolster the Bank's Qualified Thrift Lender ratio, shift funds into assets that function as more effective collateral under secured borrowing arrangements, and provide funds for further expansion in loans receivable.

Mortgage backed securities declined from $57.8 million at December 31, 1999 to $43.0 million at December 31, 2000. This reduction stemmed from ongoing principal repayments (including prepayments), maturities, and the sale of mortgage backed securities with a face value of $24.5 million, partially offset by purchases during the year. The Company decreased the size of its mortgage backed security portfolio during 2000 to raise funds for investment into higher yielding loans receivable, improve the interest rate risk profile of the Company, and generate additional liquidity for MBBC.

The Company significant altered the mix of its mortgage backed securities portfolio during 2000. Traditional Agency pass-through certificates declined from 54.1% of total mortgage backed securities at December 31, 1999 to 14.9% at December 31, 2000. In contrast, CMOs increased from 45.9% of total mortgage backed securities at December 31, 1999 to 85.1% at December 31, 2000. The Company undertook this change in mix:

- to reallocate the Company's capacity for longer term, fixed rate assets from the security portfolio to the loan portfolio, where management believes better yields are obtainable for the same level of interest rate risk

- to acquire CMOs that present relatively more certain cash flows (e.g. Planned Amortization Classes, or "PACs") than traditional pass-through certificates and thereby facilitate the Company's cash management

- to take advantage of the generally higher yields available in non-Agency CMOs versus those presented by similar profile Agency securities

All of the CMOs were rated "AAA" by at least one nationally recognized ratings agency at December 31, 2000.

Loans receivable held for investment, net of allowances for loan losses, were $391.8 million at December 31, 2000, compared to $360.7 million at December 31, 1999. This 8.6% increase stemmed from $169.7 million in credit commitments during 2000, partially offset by repayments and sales. The mix in the portfolio of loans receivable held for investment, net, changed significantly during 2000, with a reduced concentration in residential mortgages and a significant increase in the proportion of income property loans (multifamily and commercial real estate). This change in loan mix was pursued in conjunction with the Company's strategic plan of transforming itself into a community commercial bank, and thereby financing a broader range of credit needs in the communities served. This change in mix also supports a greater yield on the loan portfolio and an increase in deposits, as the Company seeks to acquire operating accounts for income properties financed and for businesses receiving a line of credit or term business loan.

In 2001, the Company intends to continue pursuing this pattern of change in loan mix. Should market conditions prove favorable, management may pursue an increase in the percentage of total loans represented by construction loans. Construction loans represented 13.9% of gross loans at December 31, 2000. While the Bank had an excess of qualifying assets over its Qualified Thrift Lender Test minimum requirement at December 31, 2000, to the extent the Bank is successful in continuing to alter its loan mix, it may need to consider changing to a commercial bank charter in the future.

The Company's investment in the capital stock of the FHLB declined in 2000 due to a mandatory redemption required by the FHLB.

The Company's balance of premises and equipment, net, increased by $333 thousand in 2000 primarily due to leasehold improvements at one branch. This branch was remodeled to enable the leasing of the second floor to a tenant, thereby increasing the Company's future monthly rental income. Management anticipates a further increase in premises and equipment in 2001 as a result of computer hardware and software purchases and licensing in conjunction with the planned new core processing system.

The Company continued to amortize its intangible assets during 2000, reducing their balance from $2.9 million at December 31, 1999 to $2.2 million at December 31, 2000. This amortization, which is a non-cash charge to operations, bolsters the Bank's regulatory capital ratios (all else held constant), as intangible assets are deducted from GAAP capital in determining regulatory capital. This amortization also increases the Company's tangible book value per share.

At December 31, 2000, the Company maintained $165 thousand in originated mortgage servicing rights, down from $253 thousand a year earlier. Because the Company has adopted a program of generally selling its loans on a servicing released basis, management anticipates that the balance of originated mortgage servicing rights will continue to decline as the existing portfolio of loans serviced for others pays off.

During the year ended December 31, 2000, the Company's liabilities increased by $20.4 million to $442.4 million, from $422.0 million at December 31, 1999. An increase in deposits more than offset declines in other types of liabilities. Total deposits rose from $367.4 million at December 31, 1999 to $407.8 million at December 31, 2000. This increase resulted from multiple factors, including the introduction of new checking and money market products and the acquisition of $14.0 million in certificates of deposit through the State of California Time Deposit Program. The Bank was also successful in attracting some deposit customers during 2000 from local competitors undergoing a merger or acquisition.

FHLB advances declined from $49.6 million at December 31, 1999 to $32.6 million at December 31, 2000. Securities sold under agreements to repurchase declined from $2.4 million at December 31, 1999 to none at December 31, 2000. The inflow of deposits and the reduction in securities provided sufficient funds to fund the growth in loans receivable, retire maturing borrowings, and prepay certain borrowings during 2000. The Company did not pursue extensive leveraging via wholesale assets and liabilities during 2000, as management determined that available risk adjusted spreads in the capital markets did not support the associated allocation of capital.

Stockholders' equity increased $3.0 million from $40.8 million at December 31, 1999 to $43.8 million at December 31, 2000, even with the repurchase of $1.25 million in Treasury shares during 2000 and the payment of $274 thousand in cash dividends during the first quarter of 2000. The rise in equity resulted from net income, continued amortization of deferred stock compensation, Company directors receiving their fees in Company stock, and an improvement in the fair value of securities classified as available for sale. The Company reduced its aggregate deferred stock compensation by $1.3 million during 2000. This significant reduction was caused by:

- ESOP shares continuing to be committed to be released under the terms of that tax qualified plan
- the distribution of certain non-qualified deferred compensation payable in Company stock
- the acceleration of benefits under the Recognition and Retention Plan for outside directors leading to the termination of that plan and the savings of future related administrative expense
- continued vesting of shares previously awarded under the Performance Equity Plan for officers and employees
- the use of Company stock for incentive payments in lieu of cash under certain employee incentive plans

Management intends to continue pursuing the accelerated amortization of deferred stock compensation and the award of Company shares in lieu of certain cash incentive payments during 2001 as a means of increasing employee ownership, more closely aligning employee interests with those of stockholders, enhancing the Company's equity position, and increasing the Company's tangible book value per share. The Board of Directors determined in early 2001 to amend the Company's Bylaws to mandate a minimum direct ownership of Company shares by the members of the Board of Directors and to continue requiring the payment of director fees in Company stock. The Board of Directors took these steps to highlight their support for the Company and to communicate their acknowledgement of the importance of aligning the Board of Directors with stockholder interests.

Given the Bank's favorable regulatory capital position at December 31, 2000, the indefinite suspension of cash dividends by the Company during 2000, and the additional liquidity and capital available at MBBC at December 31, 2000, management anticipates pursuing opportunities to expand the balance sheet during 2001. The Board of Directors plans to evaluate the merits of periodic stock repurchases during 2001.

Analysis Of Results Of Operations For The Years Ended December 31, 1999 And December 31, 1998

Overview

The Company reported net income of $3.3 million for the year ended December 31, 1999, up significantly from net income of $1.4 million realized during the prior year. These amounts translate to $1.02 basic and $0.99 diluted earnings per share in 1999, respectively, and $0.41 basic and $0.39 diluted earnings per share in 1998, respectively. The Company's return on average assets improved from 0.33% in 1998 to 0.73% in 1999. Due to the Company's equity management program, return on average equity improved more dramatically, rising from 3.29% in 1998 to 8.05% in 1999. The increase in 1999 net income resulted from the Company's continued progress and success in implementing its business strategy, complemented by a strong economy and vibrant local real estate markets, which helped constrain loan delinquencies, net charge-offs, and expenses associated with foreclosed real estate.

Net Interest Income

During the years ended December 31, 1999, and 1998, net interest income before the provision for loan losses was $16.0 million and $12.3 million, respectively. The level of average interest-earning assets over the same years was $434.8 million and $416.2 million, respectively. The net interest spread was 3.27% and 2.43%, respectively, during the years ended December 31, 1999 and 1998. During these same periods, the ratio of net interest income to average total assets was 3.53% and 2.84%, respectively.

The $3.7 million, or 30.1%, increase in net interest income generated in 1999 compared to the prior year was primarily produced by three key changes in the Company's balance sheet composition:

1. On the asset side of the balance sheet, the Company significantly redirected its asset mix towards loans receivable, reducing the proportion of the balance sheet comprised of lower yielding cash equivalents, investment securities, and mortgage backed securities. Loans receivable produced a weighted average yield rate of 8.03% during 1999, comparing favorably to 4.80% on cash equivalents, 6.40% on investment securities, and 6.68% on mortgage backed securities. This change in asset mix was enabled by a credit commitment volume of $173.3 million accomplished in 1999, partially offset by repayments and sales, that was primarily funded by the sale of securities and increased borrowings.

2. On the liability side of the balance sheet, the Company significantly reduced the percentage of deposits represented by relatively higher cost certificates in favor of a larger proportion of transaction accounts. Certificates of deposit, which generated a weighted average cost of 4.82% in 1999 and 5.41% in 1998, declined from 78.6% of average interest bearing deposits in 1998 to 65.1% in 1999. The Company successfully offset the decline in certificates of deposit with increases in lower cost checking and money market accounts. By comparison, money market accounts produced an average cost of funds of 4.03% in 1998 and 4.15% in 1999. At December 31, 1999, certificates of deposit comprised 60.5% of total deposits, down from 69.4% a year earlier.

3. The Company increased its average balance of interest earning assets by $18.5 million, or 4.5%. The Company funded this balance sheet expansion largely with an increase in borrowings, as overall deposit growth was limited by the Company's objective of decreasing its cost of deposits relative to key capital market indices such as COFI and the 1 year Treasury yield. The Company was successful in this regard, as the weighted average cost of deposits declined from 4.56% at December 31, 1998 to 4.04% at December 31, 1999, while at the same time the COFI index rose from 4.66% to 4.85% and the 1 year Treasury yield rose from 4.52% to 5.96%.

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Interest Income

For the year ended December 31, 1999, interest income was $33.4 million, an increase of $2.5 million, or 8.1%, over the amount recorded for the year ended December 31, 1998. The primary reason for the increase in interest income during 1999 was growth in average outstanding balances of loans receivable, which in turn stemmed from the level of loan production recorded during 1999. Interest income on loans receivable, which accounted for 81.4% of total interest income for the year ended December 31, 1999, grew by $6.3 million in 1999 compared to 1998. Interest income on mortgage backed securities during 1999 declined by $2.0 million from the prior year due to reduced average volumes outstanding. During 1999, the Company used scheduled payments, prepayments, and sales of mortgage backed securities as sources of cash to fund the expanding portfolio of loans receivable. Similarly, lower average volumes of investment securities during 1999 versus the prior year led to a $1.5 million year to year decline in interest income on investment securities.

The weighted average yield on interest-earning assets was 7.69% for the year ended December 31, 1999, compared to 7.43% for the prior year. The increase in the yield on interest-earning assets was principally due to loans receivable increasing as a percentage of interest-earning assets, from 62.3% during 1998 to 78.0% during 1999. Yields on mortgage backed and investment securities increased slightly during 1999, but represented a significantly smaller portion of total interest-earning assets. The increase in general market interest rates that occurred in 1999 also bolstered the Company's yield on interest earning assets, particularly those portfolios such as construction loans and corporate trust preferred securities that reprice based upon relatively responsive indices such as Prime and LIBOR, respectively. The weighted average nominal rate on the Company's loan portfolio increased from 7.92% at December 31, 1998 to 8.17% at December 31, 1999.

Interest Expense

Interest expense for the year ended December 31, 1999 was $17.4 million, compared to $18.6 million for the year ended December 31, 1998, a decrease of $1.2 million, or 6.5%. The decline in interest expense was primarily attributable to a reduction in the Company's average cost of deposits, which was a result of a combination of the change in deposit mix and from the Company's adopting a less aggressive pricing strategy, particularly for certificates of deposit, than had been employed in prior periods. The Company's average cost of interest-bearing deposits declined to 4.29% in 1999, from 4.91% in 1998. Interest expense on FHLB advances rose from $1.7 million in 1998 to $2.1 million in 1999, as the impact of greater average balances outstanding more than offset the effect of a decline in the average rate paid.

Provision For Loan Losses

For the year ended December 31, 1999 the provision for loan losses was $835 thousand, compared to $692 thousand for the year ended December 31, 1998. During 1999, the amount and timing of provisions for loan losses were primarily generated the following key factors:

- the increasing absolute size of the loan portfolio
- the continuing change in mix within the loan portfolio, away from residential mortgages to other types of lending, particularly construction loans and mortgages secured by commercial and industrial real estate
- a rise in criticized assets and classified assets from $6.4 million and $5.4 million, respectively, at December 31, 1998 to $7.9 million and $8.8 million, respectively, at December 31, 1999
- net charge-offs of $113 thousand recorded in 1999, versus net recoveries of $3 thousand in 1998

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Construction, commercial real estate, multifamily, and business lending generally involve a greater risk of loss than do mortgages on single family residences.

The Company's allowance for loan losses totaled $3.5 million at December 31, 1999, comprised of $3.3 million in general reserves and $200 thousand in specific reserves. This compares to an allowance of $2.8 million at December 31, 1998, all but $67 thousand of which was in general reserves. The allowance represented 0.96% of loans receivable at December 31, 1999, compared to 0.92% a year earlier.

Non-interest Income

Non-interest income increased by 15.1% to $2.5 million for the year ended December 31, 1999, compared to $2.2 million for the year ended December 31, 1998, primarily due to:

- a rise in net gains on the sale of mortgage backed and investment securities from $283 thousand in 1998 to $496 thousand in 1999

- customer service charges increasing from $824 thousand in 1998 to $1.0 million in 1999

- commissions from the sale of non-FDIC insured products rising from $537 thousand in 1998 to $626 thousand in 1999

The Company sold mortgage backed and investment securities in 1999 as a means of funding expansion in the loan portfolio and in order to moderate the Company's exposure to increases in general market interest rates. The increase in customer service charges in 1999 was primarily due to a larger customer base and a higher number of transaction related customer deposit accounts. The increase in commission income from sales of noninsured products reflects more effective cross-selling of these products to the Company's customer base.

Non-Interest Expense

Non-interest expense totaled $11.9 million and $11.1 million, respectively, for the years ended December 31, 1999 and 1998. Factors contributing to the rise in 1999 included:

- The operation of the Felton branch for all of 1999, versus eight months in 1998.

- The addition of staff to support the Company's greater volumes of loan origination, loan servicing, and deposit account transactions

- Increased commission expense associated with greater sales of non-FDIC insured investment products

- Higher incentive payments associated with the Company's sales and financial success in 1999

- Greater postage and data and item processing costs driven by an increased volume of transaction deposit accounts

- Non-recurring costs of $86 thousand associated with a single operating loss stemming from the operation of non-qualified benefit plans

Provision For Income Taxes

The Company recorded a provision for income taxes of $2.5 million for the year ended December 31, 1999 compared to $1.2 million during 1998. This rise was entirely associated with an increase in pre-tax income in 1999 versus 1998, as the Company's effective tax rate declined modestly in 1999 versus the prior year.

Comparison Of Financial Condition At December 31, 1999 And December 31, 1998

Total assets of the Company were $462.8 million at December 31, 1999, compared to $454.0 million at December 31, 1998, an increase of $8.8 million, or 1.9%.

Investment securities declined from $19.4 million at December 31, 1998 to $11.5 million at December 31, 1999 due to sales conducted in order to generate funding for the Company's increasing loan portfolio. The Company's investment security portfolio at December 31, 1999 was entirely composed of variable rate trust preferred securities.

Mortgage backed securities declined from $98.1 million at December 31, 1998 to $57.8 million at December 31, 1999. This reduction stemmed from ongoing principal repayments and $17.6 million in sales. This decrease was accomplished in conjunction with management's strategy of reducing interest rate risk and increasing the overall yield of interest-earning assets by selling longer duration and comparatively lower yielding mortgage backed securities and reinvesting into shorter duration and higher yielding loans receivable.

Loans receivable held for investment, net, were $360.7 million at December 31, 1999, compared to $298.8 million at December 31, 1998. This 20.7% increase stemmed from $173.3 million in credit commitments during 1999, partially offset by repayments and sales, of which the largest category was construction loans with $61.7 million in new credit commitments. Construction loans net of undisbursed loan funds rose from $27.4 million at December 31, 1998 to $55.2 million at December 31, 1999, thereby accounting for 31.0% of the overall rise in net loans receivable accomplished during 1999.

Commercial and industrial real estate loans increased from $40.0 million at December 31, 1998 to $72.3 million at December 31, 1999 in conjunction with the Company's business strategy. At December 31, 1999, residential mortgages continued to be the largest single category of the Company's net loans receivable held for investment, totaling $168.5 million, or 46.7% of the portfolio. This percentage compares to 60.8% at December 31, 1998.

The Company continued to amortize its intangible assets during 1999, reducing their balance from $3.6 million at December 31, 1998 to $2.9 million one year later. This amortization, which is a non-cash charge to operations, enhances the Bank's regulatory capital ratios, as intangible assets are deducted from GAAP capital in determining regulatory capital.

During the year ended December 31, 1999, the Company's liabilities increased by $9.1 million to $422.0 million, from $412.9 million at December 31, 1998. The increase in liabilities was primarily attributable to an increase of $14.4 million, or 40.9 %, in advances from the FHLB. The increase in advances was used primarily to fund the growth in loans receivable. None of the Company's advances at December 31, 1999 were "putable", thereby exposing the Company to increased funding costs in a rising interest rate environment. Deposits decreased to $367.4 million at December 31, 1999 from $370.7 million at December 31, 1998, as the Company focused upon changing its deposit mix and reducing its average cost of deposits in priority over building nominal deposit balances.

Shareholders equity declined $0.3 million from $41.1 million at December 31, 1998 to $40.8 million one year later. The decrease in equity occurred despite record earnings by the Company, as, during 1999:

- the Company repurchased 116,500 of its outstanding shares, which decreased shareholders' equity by $1.7 million

- accumulated other comprehensive income declined by $2.0 million due to reduced market values for the Company's security portfolios, which in turn stemmed from the increasing interest rate environment and the relatively high duration of a significant portion of the mortgage backed securities portfolio

- the Company paid $530 thousand in cash dividends

- the Company acquired $682 thousand of its stock in conjunction with its non-qualified stock compensation plans

Liquidity

Liquidity is actively managed to ensure sufficient funds are available to meet the ongoing needs of both the MBBC and the Bank. Liquidity management includes projections of future sources and uses of funds to ensure the availability of sufficient liquid reserves to provide for unanticipated circumstances. The Bank's primary sources of liquidity are deposits, principal and interest payments (including prepayments) on its asset portfolios, retained earnings, FHLB advances, other borrowings, and, to a lesser extent, sales of loans originated for sale and securities classified as available for sale. The Bank's primary uses of funds include loan originations, customer drawdowns on lines of credit and undisbursed construction loan commitments, loan purchases, customer withdrawals of deposits, interest paid on liabilities, and operating expenses.

During 2000, the Bank increased its sources of liquidity and funding by:

- Arranging four federal funds lines of credit with correspondent banks in an aggregate amount of $25.5 million. Funds under these lines are provided on an available, as opposed to on a committed, basis.

- Completing agreements to be able to issue "DTC" or publicly traded certificates of deposit through two large investment banks with significant national retail client bases.

- Signing PSA agreements with a greater number of approved counterparties to facilitate the sale of securities under agreements to repurchase.

- Pledging multifamily loans to the FHLB-SF to increase the Bank's borrowing capacity.

- Participating in the State of California Time Deposit Program.

- Distributing its security collateral to optimize its sources of funding and the cost of its funding.

The Bank pledges excess collateral to the FHLB in order to have ready access to additional liquidity. At December 31, 2000, the Bank maintained available borrowing capacity in excess of $150 million at the FHLB. In addition, at December 31, 2000, the Bank owned a significant volume of unpledged loans and securities which could be used for either liquidation or secured borrowings in order to meet future liquidity requirements.

From time to time, depending upon its asset and liability strategy, the Bank converts a portion of its residential whole loans into mortgage backed securities. These conversions provide increased liquidity because the mortgage backed securities are typically more readily marketable than the underlying loans and because they can more effectively be used as collateral for borrowings. The Bank did not securitize any portion of its residential mortgages during 2000.

The Company's ratio of loans to deposits at December 31, 2000 was 96.1%. To the extent the Company is successful in its strategic plan and further increases this ratio as a means of increasing average asset yields and the percentage of total assets comprised of loans, the Bank may need to seek alternative sources of liquidity and funding. Following the planned systems conversion in 2001, the Bank intends to pursue the specific pledging of individual loans to the FHLB (versus blanket lien), thereby increasing the volume and types of loans eligible as collateral, increasing the financial efficiency of the pledging, and augmenting the Bank's borrowing capacity.

Throughout 2000, the Bank maintained a regulatory liquidity ratio in excess of that required by the OTS. The Bank's strategy generally is to maintain its liquidity ratio slightly above the required minimum in order to maximize its yield on alternative investments. At December 31, 2000, the Bank maintained $6.4 million in commitments to fund loans. The Bank anticipates that it will have sufficient funds available to meet these commitments, not all of which will necessarily be drawn upon.

MBBC, as a company separate from the Bank, must provide for its own liquidity. Substantially all of MBBC's cash inflows are obtained from principal and interest payments on loans, interest on its security and cash equivalent positions, repayment of the funds advanced for the ESOP, exercise of vested stock options, sales of Treasury shares to the Bank for subsequent payment as director fees, and dividends declared and paid by the Bank. There are statutory and regulatory provisions that limit the ability of the Bank to pay dividends to MBBC. As of December 31, 2000, MBBC did not have any commitments for capital expenditures or to fund loans. As discussed under "Item 1. Business - Capital Requirements And Capital Categories", the Bank was informed by the OTS during the first quarter of 2000 that it would be required to maintain its regulatory capital ratios at levels equal to or above those reported at December 31, 1999. This additional regulatory capital requirement may limit the Bank's ability to pay dividends to MBBC until the requirement is terminated by the OTS.

During 2000, MBBC improved its liquidity by:

o Collecting in full on a $5.0 million business term loan that was non-performing at December 31, 1999.

o Arranging a committed $2.0 million line of credit from a correspondent bank, secured by 500 thousand shares of Treasury stock

At December 31, 2000, MBBC had cash and cash equivalents of $3.8 million. This figure increased by over $800 thousand in January, 2001 due to the exercise of vested stock options.

Capital Resources

The Bank's position as a "well capitalized" financial institution under the PCA regulatory framework is further enhanced by the financial resources present at the MBBC holding company level. At December 31, 2000, the consolidated GAAP capital position of the Bank was $40.3 million, while the consolidated GAAP capital position of the Company was $43.8 million. Note 15 to the Consolidated Financial Statements provides additional information concerning the Bank's regulatory capital position, including amounts by which the Bank exceeds minimum and "well capitalized" thresholds for regulatory capital, and the amount by which the Bank exceeds the institution specific regulatory capital requirements established by the OTS in the first quarter of 2000.

Management believes the Bank's regulatory capital position in 2000 will continue to benefit from three key factors:

- the continued amortization of intangible assets
- the continued amortization of deferred stock compensation
- the Bank's earnings for the year

The potential continued increase in the size of the loan portfolio, combined with the ongoing planned shift in mix toward construction, income property, and business lending, may result in the Bank's having higher levels of nominal and risk weighted assets during 2001, thereby possibly offsetting the effect of the above three factors upon regulatory capital ratios.

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The Company has conducted share repurchases since 1995. Through December 31, 2000, the Company had repurchased a cumulative and gross 1,269,600 shares of its common stock. At December 31, 2000, there were 3,321,210 shares outstanding. During January 2001, vested stock options representing 91,549 shares were exercised. The Company issued the shares associated with these options from Treasury stock, thereby increasing the total shares outstanding. The Board of Directors considers the appropriateness of additional share repurchases on an ongoing basis.

The Company paid cash dividends of $0.08 per share in 2000 and $0.15 per share in 1999. As previously announced, during mid 2000 the Board of Directors determined to indefinitely suspend the declaration and payment of cash dividends. In making this decision, the Board of Directors expressed their belief that alternative uses of MBBC's capital and liquidity presented more favorable financial results and impacts upon stockholder value. During the fourth quarter of 2000, MBBC invested an additional $2.1 million into the Bank to support the implementation of the strategic plan and the Bank's potential growth in 2001.

Impact of Inflation And Changing Prices

The Consolidated Financial Statements and Notes thereto presented herein have been prepared in accordance with generally accepted accounting principles ("GAAP"), which requires the measurement of most financial positions and operating results in terms of historical dollar amounts without considering the changes in the relative purchasing power of money over time due to inflation. Unlike industrial companies, the Company's assets and liabilities are nearly all monetary in nature. Consequently, relative and absolute levels of interest rates present a greater impact on the Company's performance and condition than do the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or to the same extent as the prices of goods and services. The Company's operating costs, however, are subject to the impact of inflation, particularly in the case of salaries and benefits costs, which typically constitute almost one-half of the Company's total non-interest expense. During 2000, relatively low unemployment rates contributed to increased salary and benefits costs, especially as the Company sought to continue expanding its business generation while also attracting experienced financial services industry employees to facilitate and accelerate its strategic transformation into a community based financial services firm.

Recent Accounting Pronouncements

SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities" was issued in September 2000. SFAS No. 140 is a replacement of SFAS No. 125, "Accounting for Transfers and

Servicing of Financial Assets and Extinguishments of Liabilities". Most of the provisions of SFAS No. 125 were carried forward to SFAS No. 140 without reconsideration by the FASB, and some were changed in only minor ways. In issuing SFAS No. 140, the FASB included issues and decisions that had been addressed and determined since the original publication of SFAS No. 125. SFAS No. 140 is effective for transfers and servicing of financial assets and extinguishments of liabilities occurring after March 31, 2001. Management believes that adopting these components of SFAS No. 140 will not have a material impact on the financial position or results of operations of the Company. SFAS No. 140 must be applied prospectively. For recognition and reclassification of collateral and for disclosures about securitizations and collateral, this Statement was adopted as of December 31, 2000 and did not have a material impact on the financial position or results of operations of the Company.

Item 7a. Quantitative And Qualitative Disclosure Of Market Risk.

The results of operations for financial institutions such as the Company may be materially and adversely affected by changes in prevailing economic conditions, including rapid changes in interest rates, declines in real estate market values, and the monetary and fiscal policies of the federal government. Interest rate risk ("IRR") and credit risk typically constitute the two greatest sources of financial exposure for banks and thrifts. For a discussion of the Company's credit risk, please see "Item 7. Management's Discussion And Analysis Of Financial Condition And Results Of Operations - Provision For Loan Losses". The Company utilizes no derivatives to mitigate either its credit risk or its IRR, instead relying on loan review and adequate loan loss reserves in the case of credit risk and portfolio management techniques in the case of IRR. The Company is not significantly exposed to foreign currency exchange rate risk, commodity price risk, or other market risks other than interest rate risk.

IRR represents the impact that changes in absolute and relative levels of general market interest rates might have upon the Company's net interest income, results of operations, and theoretical liquidation value, also called net portfolio value ("NPV"). Interest rate changes impact earnings and NPV in many ways, including effects upon the yields generated by variable rate assets, the cost of deposits and other sources of funds, the exercise of options embedded in various financial instruments (especially residential mortgages), and customer demand for and market supply of different financial assets, liabilities, and positions.

In order to manage IRR, the Company has established an Asset / Liability Management Committee ("ALCO"), which includes representatives from senior management and the Board of Directors. ALCO is responsible for managing the Company's financial assets and liabilities in a manner which balances profitability, IRR, and various other risks (e.g. liquidity). ALCO operates under policies and within risk limits prescribed by and periodically reviewed and approved by the Board of Directors.

The primary objective of the Company's IRR management program is to maximize net interest income while controlling IRR exposure to within prudent levels. Financial institutions are subject to IRR whenever assets and liabilities mature or reprice at different times (repricing, or gap, risk), based upon different capital markets indices (basis risk), for different terms (yield curve risk), or are subject to various embedded options, such as the right of mortgage borrowers to refinance their loans when general market interest rates decline. Companies with high concentrations of real estate lending, such as the Company, are significantly impacted by prepayment rates on loans, as such prepayments generally return investable funds to the Company at a time of relatively lower prevailing general market interest rates.

Decisions to control or accept IRR are analyzed with consideration of the probable occurrence of future interest rate changes. Stated another way, IRR management encompasses the evaluation of the likely additional return associated with an incremental change in the IRR profile of the Company. For example, having liabilities that mature or reprice faster than assets can be beneficial when interest rates decline, but may be detrimental when interest rates rise. Assessment of potential changes in market interest rates and the relative financial impact to earnings and NPV is used by the Company to help quantify and manage IRR. As with credit risk, the complete elimination of IRR would curtail the Company's profitability, as the Company generates a return, in part, through effective risk management.

The Company monitors its interest rate risk using various analytical methods that include participation in the OTS net portfolio value interest rate risk modeling. The Company's exposure to IRR as of December 31, 2000 was well within the limits established by the Board of Directors.

A common, if analytically limited, measure of financial institution IRR is the institution's "static gap". Static gap is the difference between the amount of assets and liabilities (adjusted by off balance sheet positions, if any) which are expected to mature or reprice within a specified period. A static gap is considered positive when the amount of interest rate sensitive assets exceeds the amount of interest rate sensitive liabilities in a given time period or cumulatively through that time period. The converse is true for a negative static gap.

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The following table presents the maturity and rate sensitivity of interest-earning assets and interest-bearing liabilities as of December 31, 2000. The "repricing gap" figures in the table reflect the estimated difference between the amount of interest-earning assets and interest-bearing liabilities that are contractually scheduled to mature or reprice (whichever occurs first) during future periods.

	At December 31, 2000				
	3 Months Or Less	More Than 3 Months To 1 Year	More Than 1 Year To 3 Years	More Than 3 Years To 5 Years	Over 5 Years
	(Dollars In Thousands)				
Assets					
Interest earning cash equivalents	$ 10,538	$ --	$ --	$ --	$ --
Investment securities	7,360	--	--	--	--
Mortgage backed securities	576	407	--	--	41,967
Loans receivable, net of LIP	167,795	70,278	48,527	78,537	32,228
FHLB stock	2,884	--	--	--	--
Gross interest-earning assets	189,153	70,685	48,527	78,537	74,195
Less:					
Unamortized yield adjustments	--	--	--	--	--
Allowance for loan losses	--	--	--	--	--

Interest-earning assets	189,153	70,685	48,527	78,537	74,195
Non-interest-earning assets	--	--	--	--	--
Total assets	$ 189,153	$ 70,685	$ 48,527	$ 78,537	$ 74,195
Liabilities and Equity					
NOW accounts	$ 41,859	$ --	$ --	$ --	$ --
Savings accounts	16,503	--	--	--	--
Money market accounts	87,651	--	--	--	--
Certificates of deposit	96,026	109,136	37,699	1,849	--
Total interest-bearing deposits	242,039	109,136	37,699	1,849	--
FHLB advances	--	--	25,000	1,782	5,800
Other borrowings	--	--	--	--	--
Total interest bearing liabilities	242,039	109,136	62,699	3,631	5,800
Non-interest bearing liabilities	--	--	--	--	--
Shareholders' equity	--	--	--	--	--
Total liabilities and equity	$242,039	$109,136	$ 62,699	$ 3,631	$ 5,800
Periodic repricing gap	(52,886)	(38,451)	(14,172)	74,906	68,395
Cumulative repricing gap	(52,886)	(91,337)	(105,509)	(30,603)	37,792
Periodic repricing gap as a % of interest earning assets	(11.6%)	(8.5%)	(3.1%)	16.5%	15.0%
Cumulative repricing gap as a % of interest earning assets	(11.6%)	(20.1%)	(23.2%)	(6.7%)	8.3%
Cumulative net interest-earning assets as a % of cumulative interest-bearing liabilities	78.1%	74.0%	74.5%	92.7%	108.9%

As presented in the prior table, at December 31, 2000, the Company's cumulative one year and three year static gaps, based upon contractual repricing and maturities (i.e. ignoring prepayments and other non-contractual factors) were (20.1%) and (23.2%), respectively, of total interest earning assets. These figures suggest that net interest income would increase if general market interest rates were to decline (and vice-versa), reflecting a "net liability sensitive" position.

However, static gap analysis such as that presented above fails to capture material components of IRR, and therefore provides only a limited, point in time view of the Company's IRR exposure. The assumptions and factors which are by definition excluded from static gap analysis prepared on a contractual basis encompass:

- prepayments on assets
- how rate movements and the shape of the Treasury curve, or the LIBOR swap curve, affect borrower behavior
- that all loans and deposits repricing at a given time will not adjust to the same degree or by the same magnitude
- that the nature of rate changes for assets and liabilities in the over one-year category have a greater long term economic impact than those for shorter term assets and liabilities
- transaction deposit accounts (significant to the Company) do not have scheduled repricing dates or contractual maturities, and therefore may respond to interest rate changes differently than other financial instruments
- potential Company strategic and operating responses to changes in absolute and relative interest rate levels
- the financial impact of options embedded in various financial instruments

Another measure of IRR, required to be performed by insured depository institutions regulated by the OTS, is a procedure specified by Thrift Bulletin 13a, "Interest Rate Risk Management". This test measures the impact upon NPV of an immediate and sustained change in interest rates in 100 basis point increments. The following table presents the estimated impacts of such changes in interest rates upon the Company as of December 31, 2000, calculated in compliance with Thrift Bulletin 13a. However, the results from any cash flow simulation model are dependent upon a lengthy series of assumptions about current and future economic, behavioral, and financial conditions, including many factors over which the Company has no control. These assumptions include, but are not limited to, prepayment rates on various asset portfolios and decay rates on core deposits, including savings, checking, and money market accounts. Because of the uncertainty regarding the accuracy of assumptions utilized and because such an analytical technique does not contemplate any actions the Company might undertake in response to changes in interest rates, no assurance can be provided that the valuations presented in the following table are representative of what might actually be obtainable. In addition, the following figures are by definition not indicative of the Company's economic value as a going concern or of the Company's market value.

Change In Interest Rates (In Basis Points)	NPV	Dollars
(Dollars In Thousands)		
+300	$ 52,833	$ (3,553
+200	54,839	(1,547
+100	55,777	(609
Base scenario	56,386	--
-100	55,995	(391

-200	55,386	(1,000
-300	56,133	(253

The prior table results show that the Company's liquidation value is relatively balanced in its exposure to both rising and falling interest rates. The prior table also highlights that the Company's highest theoretical liquidation value occurs in the base scenario. This position primarily results from the embedded options, held by borrowers, within most mortgage related products, as described in the following two paragraphs.

Under rising interest rates, the Company's assets experience a lengthening of duration relative to the liability side, resulting in a reduction of NPV. This occurs due to the slower prepayment behavior (under rising rates) the analysis assumed on mortgage related assets, in conjunction with embedded options such as periodic and lifetime rate adjustment caps on adjustable rate loans, all of which work to constrain aggregate asset repricing (relative to liabilities) and reduce NPV. Such results are directionally consistent with the static gap analysis presented above.

Under falling interest rates, the Company's assets experience a shortening of duration relative to the liability side, resulting in a reduction in NPV. This occurs due to the faster prepayment behavior (under falling rates) the analysis assumed on mortgage related assets, as borrowers take advantage of a lower interest rate environment to refinance their loans. This assumed refinancing provides cash flow into the Company at a time when reinvestment alternatives present lower rates than the assets being paid off.

A significant portion of the Company's total IRR exposure at December 31, 2000 was concentrated in two asset portfolios: mortgage backed securities and long term, fixed rate residential mortgages held for investment. Within the mortgage backed securities portfolio, a relatively small number of securities represent a disproportional amount of the IRR exposure, particularly a few high duration CMO's that contain relatively greater maturity extension risk.

The Company has, over the past several years, generally exhibited a greater degree of interest rate risk than presented in the above table, particularly in its exposure to rising interest rate scenarios. During 2000, the Company's IRR exposure has been reduced through a combination of several strategies, including:

o increasing core deposits, particularly checking accounts, as a means of increasing the weighted average duration of the Company's funding

o originating and retaining variable-rate loans, including those tied to relatively responsive capital markets indices such as the 1 Year CMT and the Wall Street Journal Prime Rate

o selling fixed-rate mortgage-backed securities from the available for sale portfolio to fund loan growth

o concentrating new security purchases in relatively low duration, high cash flow, strongly structured CMO's

o selling the vast majority of the new production of fixed rate, residential mortgages into the secondary market

o continuing to diversify the loan portfolio away from its historic concentration in residential mortgages towards increased income property lending, which typically generates more interest sensitive, and higher yielding, assets

Despite the Company's IRR management program and the initiatives detailed above, due to the multiple factors which influence the Company's exposure to IRR, many of which are beyond the control of the Company, there can be no assurance that the Company's earnings or economic value will be maintained in future periods, nor that the Company will be successful in continuing to maintain a relatively balanced IRR exposure.

Item 8. Financial Statements And Supplementary Data.

Index To Consolidated Financial Statements

INDEPENDENT AUDITORS' REPORT

The Board of Directors
Monterey Bay Bancorp, Inc.
Watsonville, California

We have audited the accompanying consolidated statements of financial condition of Monterey Bay Bancorp, Inc. and subsidiary (the "Company") as of December 31, 2000 and 1999, and the related consolidated statements of operations, changes in stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2000. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Monterey Bay Bancorp, Inc. and subsidiary as of December 31, 2000 and 1999, and the results of their operations and their cash flows, for each of the three years in the period ended December 31, 2000, in conformity with accounting principles generally accepted in the United States of America.

/s/ Deloitte & Touche LLP
San Francisco, California
February 8, 2001

MONTEREY BAY BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
DECEMBER 31, 2000 AND 1999
(Dollars In Thousands, Except Per Share Amounts)

ASSETS	
Cash and cash equivalents	$
Securities available for sale, at estimated fair value:	
Investment securities	
Mortgage backed securities	
Securities held to maturity, at amortized cost:	
Mortgage backed securities (fair value 1999: $60)	
Loans receivable held for investment (net of allowances for loan losses of $5,364 at December 31, 2000 and $3,502 at December 31, 1999)	3
Investment in capital stock of the Federal Home Loan Bank, at cost	
Accrued interest receivable	
Premises and equipment, net	
Core deposit premiums and other intangible assets, net	
Real estate acquired via foreclosure, net	
Other assets	
TOTAL ASSETS	$4
LIABILITIES AND STOCKHOLDERS' EQUITY	
LIABILITIES	
Deposits	$4
Advances from the Federal Home Loan Bank	
Securities sold under agreements to repurchase	
Accounts payable and other liabilities	

Total liabilities	4
Commitments and contingencies	
STOCKHOLDERS' EQUITY	
Preferred stock, $0.01 par value, 2,000,000 authorized; none issued) Common stock, $0.01 par value, 9,000,000 shares authorized;	
4,492,085 issued at December 31, 2000 and December 31, 1999; 3,321,210 outstanding at December 31, 2000 and 3,422,637 outstanding at December 31, 1999	
Additional paid-in capital	
Retained earnings, substantially restricted	
Unallocated ESOP shares	
Treasury shares designated for compensation plans, at cost (35,079 shares at December 31, 2000 and 126,330 shares at December 31, 1999)	
Treasury stock, at cost (1,170,875 shares at December 31, 2000 and 1,069,448 shares at December 31, 1999)	(
Accumulated other comprehensive loss, net of taxes	
Total stockholders' equity	
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$4

MONTEREY BAY BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF OPERATIONS
YEARS ENDED DECEMBER 31, 2000, 1999, AND 1998
(Dollars In Thousands, Except Per Share Amounts)

	Year Ended D	
INTEREST AND DIVIDEND INCOME:	2000	
Loans receivable	$ 32,556	$ 27
Mortgage backed securities	3,755	4
Investment securities and cash equivalents	1,446	1
Total interest and dividend income	37,757	33
INTEREST EXPENSE:		
Deposit accounts	17,231	15
Federal Home Loan Bank advances and other borrowings	2,546	2
Total interest expense	19,777	17

NET INTEREST INCOME BEFORE PROVISION FOR LOAN LOSSES	17,980	16
PROVISION FOR LOAN LOSSES	2,175	
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	15,805	15
NON-INTEREST INCOME:		
(Losses) gains on sale of mortgage backed securities and investment securities, net	(55)	
Commissions from sales of noninsured products	676	
Customer service charges	1,306	1
Income from loan servicing	118	
Other income	295	
Total	2,340	2
NON-INTEREST EXPENSE:		
Compensation and employee benefits	6,569	5
Occupancy and equipment	1,278	1
Deposit insurance premiums	188	
Data processing fees	1,142	
Legal and accounting expenses	661	
Supplies, postage, telephone, and office expenses	679	
Advertising and promotion	361	
Amortization of intangible assets	723	
Other expenses	2,075	1
Total	13,676	11
INCOME BEFORE INCOME TAXES	4,469	5
PROVISION FOR INCOME TAXES	1,946	2
NET INCOME	$2,523	$3
EARNINGS PER SHARE:		
BASIC EARNINGS PER SHARE	$ 0.81	$
DILUTED EARNINGS PER SHARE	$ 0.81	$

MONTEREY BAY BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
YEARS ENDED DECEMBER 31, 2000, 1999 AND 1998
(Dollars And Shares In Thousands)

Shares

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings	Unallocated ESOP Shares	Designated For Compensation Plans	Trea S
Balance At January 1, 1998	4,037	$45	$ 27,347	$ 26,729	$(1,610)	$(1,210)	$(4
Purchase of treasury stock	(567)						(8
Options exercised using treasury stock	35		50				
Dividends paid ($0.12 per share)				(463)			
Amortization of stock compensation			429		230	259	
Comprehensive income:							
Net income				1,436			
Other comprehensive income:							
Change in net unrealized gain on securities available for sale, net of taxes of $583							
Reclassification adjustment for gains on securities available for sale included in income, net of taxes of $(118)							
Other comprehensive income, net							
Total comprehensive income							
Balance at December 31, 1998	3,505	$45	$ 27,826	$ 27,702	$(1,380)	$(951)	$(12

MONTEREY BAY BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (Continued)
YEARS ENDED DECEMBER 31, 2000, 1999 AND 1998

(Dollars And Shares In Thousands)

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings	Unallocated ESOP Shares	Shares Designated For Compensation Plans	Trea S
Balance At December 31, 1998	3,505	$45	$ 27,826	$ 27,702	$(1,380)	$(951)	$(12
Purchase of treasury stock	(116)						(1
Options exercised using treasury stock	34		60				
Dividends paid ($0.15 per share)				(530)			
Amortization of stock compensation			351		230	257	
Purchase of stock for stock compensation plans						(682)	
Comprehensive income:							
Net income				3,301			
Other comprehensive income:							
Change in net unrealized gain / (loss) on securities available for sale, net of taxes of $(1,168)							
Reclassification adjustment for gains on securities available for sale included in income, net of taxes of $(204)							
Other comprehensive income, net							
Total comprehensive income							
Balance at December 31, 1999	3,423	$45	$ 28,237	$ 30,473	$(1,150)	$ (1,376)	$(14

MONTEREY BAY BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (Continued)
YEARS ENDED DECEMBER 31, 2000, 1999 AND 1998
(Dollars And Shares In Thousands)

	Common Stock		Additional Paid-In	Retained	Unallocated ESOP	Treasury Shares Designated For Compensation	Trea
	Shares	Amount	Capital	Earnings	Shares	Plans	S
Balance At December 31, 1999	3,423	$45	$ 28,237	$ 30,473	$(1,150)	$(1,376)	$(14
Purchase of treasury stock	(120)						(1
Cash dividends paid ($0.08 per share)				(274)			
Director fees paid using treasury stock	18		9				
Amortization of stock compensation			32		230	822	
Sale of stock for stock compensation plans						216	
Comprehensive income:							
Net income				2,523			
Other comprehensive income:							
Change in net unrealized gain / (loss) on securities available for sale, net of taxes of $359							
Reclassification adjustment for losses on securities available for sale included in income, net of taxes of $23							
Other comprehensive income, net							
Total comprehensive income							

Balance at December 31, 2000	3,321	$45	$ 28,278	$ 32,722	$ (920)	$ (338)	$(15

MONTEREY BAY BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2000, 1999, AND 1998
(Dollars In Thousands)

	Year End	
	2000	
OPERATING ACTIVITIES:		
Net income	$ 2,523	$ 3
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of premises and equipment	441	
Amortization of intangible assets	723	
Amortization of purchase premiums, net of accretion of discounts	104	
Amortization of deferred loans fees	(250)	
Provision for loan losses	2,175	
Provision for real estate losses	--	
Federal Home Loan Bank stock dividends	(214)	
Gross ESOP expense before dividends received on unallocated shares	334	
Compensation expense related to stock compensation plans	296	
Loss (gain) on sale of investment and mortgage-backed securities	55	
(Gain) loss on the sale of loans held for sale	(22)	
Loss (gain) on sale of real estate acquired via foreclosure	5	
(Gain) loss on sale of fixed assets	--	
Origination of loans held for sale	(2,652)	(6
Proceeds from sales of loans held for sale	2,674	8
Deferred income taxes	(595)	
(Increase) decrease in accrued interest receivable	(213)	
Decrease (increase) in other assets	566	(1
(Decrease) increase in accounts payable and other liabilities	(647)	
Other, net	(1,280)	1
Net cash provided by operating activities	4,023	7
INVESTING ACTIVITIES:		
Net increase in loans held for investment	(31,134)	(61
Purchases of investment securities available for sale	--	
Proceeds from maturities of investment securities	--	
Proceeds from sales of investment securities available for sale	3,730	8
Purchases of mortgage backed securities available for sale	(26,818)	

Principal repayments on mortgage backed securities available for sale	18,422	19
Proceeds from maturities of mortgage backed securities held to maturity	60	
Proceeds from sales of mortgage backed securities available for sale	24,425	17
Redemptions (purchases) of FHLB stock, net	543	
Purchases of premises and equipment	(774)	(1
Proceeds from the sale of premises and equipment	--	
Net cash used in investing activities	(11,546)	(17

MONTEREY BAY BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)
YEARS ENDED DECEMBER 31, 2000, 1999, AND 1998
(Dollars In Thousands)

	Year Ended	
	2000	
FINANCING ACTIVITIES:		
Net increase (decrease) in deposits	40,386	(3
(Repayments) proceeds of FHLB advances, net	(17,000)	14
(Repayments) proceeds of securities sold under agreements to repurchase, net	(2,410)	(2
Cash dividends paid to stockholders	(274)	
Purchases of treasury stock	(1,251)	(1
Sales of treasury stock	182	
Sales (purchases) of stock for stock compensation plans, net	216	
Net cash provided by financing activities	19,849	6
NET INCREASE (DECREASE) IN CASH & CASH EQUIVALENTS	12,326	(4
CASH & CASH EQUIVALENTS AT BEGINNING OF YEAR	12,833	16
CASH & CASH EQUIVALENTS AT END OF YEAR	$ 25,159	$ 12
SUPPLEMENTAL CASH FLOW DISCLOSURES:		
Cash paid during the period for:		
Interest on deposits and borrowings	19,655	17
Income taxes	3,060	3

SUPPLEMENTAL DISCLOSURES OF NON CASH
INVESTING AND FINANCING ACTIVITIES

Loans transferred to held for investment, at market value	385
Mortgage backed securities acquired in exchange for securitized loans, net of deferred fees	--
Real estate acquired in settlement of loans	--

MONTEREY BAY BANCORP, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2000, 1999, AND 1998

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1. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization And Nature Of Operations

Monterey Bay Bancorp, Inc. ("MBBC") is a unitary savings and loan holding company incorporated in 1994 under the laws of the state of Delaware. MBBC operates as the holding company for its wholly owned subsidiary Monterey Bay Bank (the "Bank"), a federally chartered savings and loan association. The Bank has one wholly owned subsidiary, Portola Investment Corporation ("Portola"), which sells various non-FDIC insured investment products and provides trustee services to the Bank. Portola operates within the Bank's facilities in segregated areas. MBBC, the Bank, and Portola are hereinafter collectively referred to as the "Company".

The Company's primary business is attracting checking, money market, savings, and certificate of deposit accounts through its branch facilities and various electronic means, and investing such deposits and other available funds in various types of loans, including real estate mortgages, business loans, construction loans, and consumer loans. The Company also provides a range of fee based services. The Bank's deposit gathering and lending markets are primarily concentrated in the communities surrounding its full service offices located in Santa Cruz, Northern Monterey, and Southern Santa Clara Counties, in California. At December 31, 2000, the Bank maintained eight full service branch offices and eleven ATM's, two of which were stand-alone.

Summary Of Significant Accounting Policies

Basis of Consolidation - The consolidated financial statements include the accounts of Monterey Bay Bancorp, Inc. and its wholly-owned subsidiary, Monterey Bay Bank, and the Bank's wholly-owned subsidiary, Portola Investment Corporation. All significant inter-company transactions and balances are eliminated in consolidation.

Financial Statement Presentation And Use Of Estimates - The financial statements have been prepared and presented in accordance with accounting principles generally accepted in the United States of America, or "GAAP" and general practices within the banking and savings and loan industry. The preparation of the financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, and contingent assets and liabilities, and disclosure of contingent assets and liabilities, as of the balance sheet dates and revenues and expenses for the reporting periods. Actual results could differ from those estimates.

Cash And Cash Equivalents - Cash and cash equivalents include cash on hand, amounts due from banks, federal funds sold, investments in money market mutual funds, securities purchased under agreements to resell with original maturities of three months of less, certificates of deposit with original maturities of three months or less, and highly liquid debt instruments purchased with remaining terms to maturity of three months or less from the date of acquisition.

Securities Purchased Under Agreements To Resell - The amounts advanced under these agreements represent short-term loans and are accounted for as a secured lending and carried at cost as an asset in the Consolidated Statement of Financial Condition. The Company may sell, loan, or otherwise dispose of such securities to other parties in the normal course of operations. The identical or substantially the same securities are to be resold at the maturity of the agreements. The Company usually enters into these agreements with terms to maturity of three months or less.

Securities Available For Sale - Securities to be held for indefinite periods of time, including securities that management intends to use as part of its asset / liability management strategy that may be sold in response to changes in interest rates, loan prepayments, or other factors, are classified as available for sale. Securities available for sale are carried at estimated fair value. Gains or losses on the sale of securities are determined using the specific identification method. Premiums and discounts are recognized in interest income using the interest method over the period to contractual maturity. Unrealized holding gains or losses, net of tax, for securities available for sale are reported as a component of other comprehensive income.

Securities Held To Maturity - Securities held to maturity are recorded at amortized cost, with any premium or discount recognized in interest income using the interest method over the period to contractual maturity. The Company has the ability and management has the positive intent to hold these securities to maturity. The Company designates securities as held to maturity or available for sale upon acquisition.

A decline in the fair value of individual securities held to maturity and securities available for sale below their cost that is deemed other than temporary would be recognized through a write down of the investment securities to their fair value by a charge to earnings as a realized loss.

For the years ended December 31, 2000 and 1999, the Company did not have any securities classified as trading.

Mortgage Backed Securities - The Company's mortgage backed securities include collateralized mortgage obligations ("CMO's") issued by both federal Agencies and private entities ("private label CMO's"). Private label CMO's expose the Company to credit and liquidity risks not typically present in federal Agency issued securities.

Loans Held For Sale - Loans held for sale are carried at the lower of aggregate cost, including qualified loan origination costs and related fees, or estimated fair value, grouped by category. Unrealized losses by category are recognized via a charge against operations. Realized gains and losses on loans held for sale are accounted for under the specific identification method. Qualified loan origination fees and costs are retained and not amortized during the period the loans are held for sale. Transfers of loans held for sale to the held for investment portfolio are recorded at the lower of cost or estimated fair value on the transfer date. While the Company had no loans held for sale at December 31, 2000 and 1999, it did originate and hold loans for sale during each of the three years ended December 31, 2000, 1999, and 1998.

Loans Receivable Held For Investment - Loans receivable held for investment are stated at unpaid principal balances less undisbursed loan funds for constructions loans, unearned discounts, deferred loan origination fees, and allowances for estimated loan losses, plus unamortized premiums (including purchase premiums) and qualified deferred loan origination costs. These loans are not adjusted to the lower of cost or market because it is management's intention, and the Company has the ability, to hold these loans to maturity.

Interest Income On Loans - Interest income on loans is accrued and credited to income as it is earned. However, interest is generally not accrued on loans over 90 days contractually delinquent. In addition, interest is not accrued on loans that are less than 90 days contractually delinquent, but where management has identified concern over future collection. Accrued interest income is reversed when a loan is placed on non-accrual status. Discounts, premiums, and net deferred loan origination fees are amortized into interest income over the contractual lives of the related loans using a procedure approximating the interest method, except when a loan is in non-accrual status. When a loan pays off or is sold, any unamortized balance of any related premiums, discounts, and qualified net deferred loan origination fees is recognized in income. Payments received on non-accrual loans are allocated between principal and interest based upon the terms of the underlying note.

Sales Of Loans - Gains or losses resulting from sales of loans are recorded at the time of sale and are determined by the difference between (i) the net sales proceeds plus the estimated fair value of any interests retained in the loans, such as loan servicing rights, and (ii) the carrying value of the assets sold. The difference between the adjusted carrying value of the interests retained and the face amount of the interests retained is amortized to operations over the estimated remaining life of the associated loans using a method that approximates the interest method. The fair value of any interests retained is periodically evaluated, with any shortfall in estimated fair value versus carrying amount being charged against operations.

Securitization Of Loans - Effective January 1, 1999, the Company adopted SFAS No. 134, Accounting For Mortgage-Backed Securities Retained After The Securitization Of Mortgage Loans Held for Sale By A Mortgage Banking Enterprise. SFAS No. 134 permits companies that hold mortgage loans for sale to classify mortgage-backed securities retained in a securitization of such loans as either held-to-maturity, available for sale, or trading based on the Company's capacity and management's intent, unless the Company has already committed to sell the security before or during the securitization process. This guidance is consistent with the treatment established for investments covered by SFAS 115, Accounting For Certain Investments In Debt And Equity Securities.

Troubled Debt Restructured - A loan is considered "troubled debt restructured" when the Company provides the borrower certain concessions that it would not normally consider. The concessions are provided with the objective of maximizing the recovery of the Company's investment. Troubled debt restructured includes situations in which the Company accepts a note (secured or unsecured) from a third party in payment of its receivable from the borrower, other assets in payment of the loan, an equity interest in the borrower or its assets in lieu of the Company's receivable, or a modification of the terms of the debt including, but not limited to, (i) a reduction in the stated interest rate to below market rates, (ii) an extension of maturity at an interest rate or other terms below market, (iii) a reduction in the face amount of the debt, and / or (iv) a reduction in the accrued interest receivable.

Impaired Loans - The Company accounts for impaired loans in accordance with SFAS No. 114, Accounting By Creditors For Impairment Of A Loan, as amended by SFAS No. 118, Accounting By Creditors For Impairment Of A Loan - Income Recognition And Disclosures. SFAS No. 114 generally requires all creditors to account for impaired loans, except those loans that are accounted for at fair value or at the lower of cost or fair value, at the present value of the expected future cash flows discounted at the loan's effective interest rate at the date of initial impairment, or, as a practical expedient, at the loan's observable market price or fair value of the collateral if the loan is collateral dependent. SFAS No. 114 indicates that a creditor should evaluate the collectibility of both contractual interest and contractual principal when assessing the need for a loss accrual. Interest income received on impaired non-accrual loans is recognized on a cash basis. Interest income on other impaired loans is recognized on an accrual basis.

The Company considers a loan to be impaired when it is deemed probable by management that the Company will be unable to collect all contractual interest and contractual principal payments in accordance with the terms of the original loan agreement. However, when determining whether a loan is impaired, management also considers the current ratio of the loan's balance to collateral value, other sources of repayment, and the borrower's present financial position. In evaluating whether a loan is considered impaired, insignificant delays or shortfalls in payments, in the absence of other facts and circumstances, would not alone lead to the conclusion that a loan is impaired. The Company includes among impaired loans all loans that (i) are contractually delinquent 90 days or more, (ii) meet the definition of a troubled debt restructuring, (iii) are classified in part or in whole as either doubtful or loss, (iv) the Company has suspended accrual of interest, and (v) have a specific loss allowance applied to adjust the loan to fair value.

The Company applies the measurement provisions of SFAS No. 114 to all loans in its portfolio, and utilizes the cash basis method of accounting for payments received on impaired loans.

Allowances For Loan Losses - Specific valuation allowances are established for loans that are deemed impaired if the fair value of the loan or the collateral is estimated to be less than the Company's investment in the loan. In developing specific valuation allowances, the Company considers (i) the estimated cash payments expected to be received by the Company, (ii) the estimated net sales proceeds from the loan or its collateral, (iii) cost of refurbishment, (iv) certain operating income and expenses, and (v) the costs of acquiring and holding the collateral. The Company charges off a portion of an impaired loan against the specific valuation allowance when that portion is deemed probable to not be recoverable.

General valuation allowances are maintained at levels that management believes adequate to cover inherent losses in the loan portfolio and are continually reviewed and adjusted. The Company adheres to an internal asset review system and an established loan loss reserve methodology. Management evaluates factors such as the prevailing and anticipated economic conditions, including the duration of the current business cycle, seasoning of the loan portfolio, historic loss experiences, composition of the loan portfolio by collateral and product types, levels and trends of criticized and classified loans, and loan delinquencies in assessing overall valuation allowance levels to be maintained. While management uses currently available information to provide for estimated losses on loans, additions to or recoveries from the general valuation allowance may be necessary based upon a number of factors including, but not limited to, changes in economic conditions and credit quality trends, particularly in the real estate market, borrower financial status, the regulatory environment, real estate values, and loan portfolio size and composition. Many of these factors are beyond the Company's control and, accordingly, periodic provisions for estimated loan losses may vary from time to time. In addition, various regulatory agencies, as an integral part of the examination process, periodically review the Bank's allowance for estimated loan losses. Such regulatory agencies may develop judgements different from those of management and may require the Bank to recognize additional provisions against operations.

Real Estate Owned - Real estate acquired through foreclosure is initially recorded at the lower of amortized cost or fair value less estimated costs to sell. If the fair value less estimated costs to sell is less than amortized cost, a charge against the allowance for loan losses is recorded at property acquisition. Declines in property fair value less estimated costs to sell subsequent to acquisition are charged to operations. Expenses incurred in conjunction with the maintenance of real estate acquired through foreclosure are charged to operations.

Recognition of gains on the sale of real estate is dependent upon the transaction meeting certain criteria relating to the nature of the property and the terms of the sale and potential financing. Losses on disposition of real estate, including expenses incurred in connection with the disposition, are charged to operations.

Allowances For Real Estate Losses - Allowances for real estate acquired by foreclosure are established based upon management's estimates of fair value less costs to sell. Such estimates may change from time to time based upon a number of factors, including, but not limited to, general economic conditions and the level of local demand for the specific properties. The Bank's allowances for real estate assets are also subject to review and adjustment by various regulatory agencies.

Premises And Equipment - Land is carried at cost. Other premises and equipment are stated at cost, less accumulated depreciation and amortization. The Company's policy is to depreciate or amortize premises and equipment on a straight-line basis over the estimated useful lives of the various assets, and to amortize leasehold improvements over the shorter of the asset's useful life or the term of the lease. The useful lives for the principal classes of assets are:

Asset	Useful Life
Buildings	30 to 40 years
Leasehold improvements	Shorter of term on lease or life of improvement
Furniture and equipment	3 to 10 years

The cost of repairs and maintenance is charged to operations as incurred, whereas expenditures that improve or extend the service lives of assets are capitalized.

Impairment Of Long-Lived Assets - The Company periodically evaluates the recoverability of long-lived assets in accordance with SFAS No. 121, Accounting For Impairment Of Long-Lived Assets And For Long-Lived Assets To Be Disposed Of. Long-lived assets and certain identifiable intangibles to be held and used are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of assets may not be recoverable. Determination of recoverability is based on an estimate of undiscounted future cash flows resulting from the use of the asset and its eventual disposition. Measurement of an impairment loss for long-lived assets and identifiable intangibles that management expects to hold and use are based on the fair value of the asset. Long-lived assets and certain identifiable intangibles to be disposed of are reported at the lower of carrying amount or fair value less estimated cost to sell.

Core Deposit Intangibles - These assets arise from the acquisition of deposits and are amortized on a straight-line basis over the estimated life of the deposit base acquired, generally seven years. The Company periodically evaluates the periods of amortization to determine whether later events and circumstances warrant revised estimates.

Securities Sold Under Agreements To Repurchase - The Company enters into sales of securities under agreements to repurchase with selected dealers and banks. Such agreements are treated as financings. The obligations to repurchase securities sold are reflected as a liability in the Consolidated Statements of Financial Condition. The securities underlying the agreements are delivered to the dealer or bank with whom each transaction is executed. The dealers or banks, who may sell, loan, or otherwise dispose of such securities to other parties in the normal course of their operations, agree to resell the Company either the identical or substantially the same securities at the maturities of the agreements. The Company retains the right of substitution of collateral throughout the terms of the agreements. The Company usually enters into these agreements with terms to maturity of three months or less.

Stock Based Compensation - The Company accounts for its stock option and stock award plans under SFAS No. 123, Accounting For Stock-Based Compensation. This

Statement establishes financial accounting and reporting standards for stock-based compensation plans. These standards include the recognition of compensation expense over the vesting period of the fair value of all stock-based awards on the date of grant. Alternatively, SFAS. No 123 also permits entities to continue to apply the provisions of APB No. 25, Accounting For Stock Issued To Employees, and provide pro forma net earnings (loss) and pro forma net earnings (loss) per share disclosures as if the fair value based method defined in SFAS No. 123 had been applied. The Company has elected to continue to apply the provisions of APB No. 25, using the intrinsic value method of accounting for stock based compensation, and provide the pro forma disclosure requirements of SFAS No. 123 in the footnotes to its audited financial statements.

Employee Stock Ownership Plan ("ESOP") - The Company accounts for shares acquired by its ESOP in accordance with the guidelines established by the American Institute of Certified Public Accountants Statement of Position 93-6, Employers' Accounting for Employee Stock Ownership Plans ("SOP 93-6"). Under SOP 93-6, the Company recognizes compensation cost equal to the fair value of the ESOP shares during the periods in which they become committed to be released. To the extent that the fair value of the Company's ESOP shares committed to be released differ from the cost of such shares, the differential is charged or credited to equity. Employers with internally leveraged ESOPs such as the Company do not report the loan receivable from the ESOP as an asset and do not report the ESOP debt from the employer as a liability. The Company's ESOP is a tax-qualified plan. Non-vested shares owned by the ESOP are accounted for via a contra-equity account based upon historic cost. ESOP shares that have not been committed to be released (uncommitted shares) are excluded from outstanding shares on a weighted average basis for earnings per share calculations.

Income Taxes - The Company accounts for income taxes under SFAS No. 109, Accounting For Income Taxes, which follows the liability method. Under this method, deferred tax assets and deferred tax liabilities are recognized for future tax consequences attributable to temporary differences between the financial statement carrying amounts of certain existing assets and liabilities, and their respective bases for Federal income and California franchise taxes. Deferred tax assets and liabilities are calculated by applying current effective tax rates against future deductible or taxable amounts. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in operations in the period that includes the enactment date. Future tax benefits attributable to temporary differences are recognized to the extent the realization of such benefits is more likely than not.

Commissions From Sales Of Non-FDIC Insured Products - The Company realizes commissions from the sales of various non-FDIC insured products, including mutual funds, annuities, and specific securities, as a result of business conducted through Portola. Commission income is typically based upon a percentage of sales. Periodic commission income varies based on the volume and mix of investment products sold, and is recognized on an accrual basis for certain transactions where the amount is determinable as earned, and on a cash basis for other transactions.

Stock Split - In July, 1998, the Company authorized a five for four stock split thereby increasing the number of issued and outstanding shares. All references in the accompanying financial statements to the number of common shares and per share amounts have been restated to reflect the stock split.

Earnings Per Share - The Company follows SFAS No. 128, Earnings Per Share, in calculating basic and diluted earnings per share. Basic earnings per share excludes dilution and is computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflects the potential dilution that could occur if contracts to issue common stock or securities convertible into common stock were exercised or converted. Dilution resulting from the Company's stock option and stock award plans is calculated using the treasury stock method.

Comprehensive Income - Comprehensive income includes (i) net income and (ii) other comprehensive income. The Company's only source of other comprehensive income is derived from unrealized gains and losses on securities available for sale. The Company displays comprehensive income within the Consolidated Statements of Changes in Stockholders' Equity. Reclassification adjustments result from gains or losses on securities that were realized and included in net income of the current period that also had been included in other comprehensive income as unrealized holding gains or losses in the period in which they arose. Such adjustments are excluded from current period comprehensive income in order to avoid double counting.

Segment Disclosure - The Company operates a single line of business (financial services) with no customer accounting for more than 10.0% of its revenue and manages its operation under a unified management and reporting structure. Therefore, no additional segment disclosures are required.

Derivative Instruments and Hedging Activities - SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, is effective for all fiscal years beginning after June 15, 2000. SFAS No. 133, as amended, establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities. Under SFAS No. 133, as amended, certain contracts that were not formerly considered derivatives may now meet the definition of a derivative. The Company will adopt SFAS No. 133 effective January 1, 2001. Management believes the adoption of SFAS No. 133 will not have a significant impact upon the financial position, results of operations, or cash flows of the Company.

Reclassifications - Certain reclassifications have been made to prior period financial statements to conform them to the current year presentation.

Recent Accounting Developments

SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities" was issued in September 2000. SFAS No. 140 is a replacement of SFAS No. 125, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities". Most of the provisions of SFAS No. 125 were carried forward to SFAS No. 140 without reconsideration by the FASB, and some were changed in only minor ways. In issuing SFAS No. 140, the FASB included issues and decisions that had been addressed and determined since the original publication of SFAS No. 125. SFAS No. 140 is effective for transfers and servicing of financial assets and extinguishments of liabilities occurring after March 31, 2001. Management believes that adopting these components of SFAS No. 140 will not have a material impact on the financial position or results of operations of the Company. SFAS No. 140 must be applied prospectively. For recognition and reclassification of collateral and for disclosures about securitizations and collateral, this Statement was adopted as of December 31, 2000 and did not have a material impact on the financial position or results of operations of the Company.

MONTEREY BAY BANCORP, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2000, 1999, AND 1998 (Continued)

2. CASH AND CASH EQUIVALENTS

Cash and cash equivalents are summarized as follows:

	December 31, 2000	December 31, 1999
	(Dollars In Thousands)	
Cash on hand	$ 1,483	$ 3,667
Due from banks	13,544	9,066
Certificates of deposit	187	--
Federal funds sold	6,735	--
Money market mutual funds	3,210	100
	$ 25,159	$ 12,833

3. INVESTMENT SECURITIES

The amortized cost and estimated fair value of investment securities are presented below. All securities held are publicly traded.

December 31, 2000	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses
	(Dollars In Thousands)		
Available for sale			
Corporate trust preferreds	$ 7,696	$ --	$ (336)

December 31, 1999	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses
	(Dollars In Thousands)		
Available for sale			
Corporate trust preferreds	$ 11,456	$ 50	$ (43)

The following table shows the amortized cost, estimated fair value, and weighted average yield of the Company's investment securities by year of contractual maturity. Actual maturities may differ from contractual maturities due to rights of issuers to call obligations.

	December 31, 2000	
	Amortized Cost	Estimated Fair Value
	(Dollars In Thousan	
Available for sale		
Corporate trust preferreds		
Due in 2011 and thereafter	$ 7,696	$ 7,360

Proceeds from and realized gains and losses on sales of investment securities available for sale are summarized as follows:

	Year Ended December	
	2000	1999
	(Dollars In Thou	
Proceeds from sales	$ 3,730	$ 8,005
Gross realized gains on sales	--	518
Gross realized losses on sales	44	--

4. MORTGAGE BACKED SECURITIES

The amortized cost and estimated fair value of mortgage backed securities are presented below. All securities held are publicly traded.

	December 31, 2000		
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses
	(Dollars In Thousands)		
Available for sale			
FHLMC pass-through certificates	$ 1,090	$ 13	$ --
FNMA pass-through certificates	4,220	30	(2)
GNMA pass-through certificates	1,060	--	(11)
CMOs:			
Agency issuance	19,095	5	(266)
Non Agency issuance	18,210	4	(498)
	$43,675	$ 52	$ (777)

	December 31, 1999		
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses
	(Dollars In Thousands)		
Available for sale			
FHLMC pass-through certificates	$ 1,930	$ --	$ (36)
FNMA pass-through certificates	25,132	95	(379)
GNMA pass-through certificates	4,531	--	(96)
CMOs:			
Agency issuance	11,152	--	(974)
Non Agency issuance	16,965	--	(604)
	$59,710	$ 95	$(2,089)
Held to maturity			
FNMA pass-through certificates	$ 60	$ --	$ --

MONTEREY BAY BANCORP, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2000, 1999, AND 1998 (Continued)

The following table shows the amortized cost, estimated fair value, and weighted average yield of the Company's mortgage backed securities by year of contractual maturity. Actual maturities may differ from contractual maturities due to principal prepayments or rights of issuers to call obligations.

	December 31, 20	
	Amortized Cost	Estimated Fair Value
	(Dollars In Thousa	
Available for sale		
Due in 2001	$ 406	$ 407
Due in 2006 through 2010	7,572	7,558
Due in 2011 and thereafter	35,697	34,985
	$43,675	$42,950

Proceeds from and realized gains and losses on sales of mortgage backed securities available for sale are summarized as follows:

	Year Ended Decembe	
	2000	1999
	(Dollars In Thousa	
Proceeds from sales	$ 24,425	$ 17,643
Gross realized gains on sales	72	30
Gross realized losses on sales	83	52

The Company pledges mortgage backed securities to the Federal Home Loan Bank as collateral for advances, to the State of California as collateral for certain deposits, and to the Federal Reserve as collateral for certain customer payments. The following table details the amortized cost of mortgage backed securities not pledged and pledged for various purposes:

	December 31,	
	2000	1999
	(Dollars In Thousands)	
Not pledged	$ 7,010	$ 16,017
Pledged to the Federal Home Loan Bank	18,210	43,316
Pledged to the State of California	18,058	--
Pledged to the Federal Reserve	397	437
	$ 43,675	$ 59,770

5. LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES

Loans receivable, net are summarized as follows:

	December
	2000
	(Dollars In
Held for investment:	
Loans secured by real estate:	
Residential one to four unit	$160,155
Multifamily five or more units	76,727

Commercial and industrial	102,322
Construction	59,052
Land	16,310
Sub-total loans secured by real estate	414,566
Other loans:	
Home equity lines of credit	5,631
Loans secured by deposits	494
Consumer lines of credit, unsecured	175
Business term loans	1,641
Business lines of credit	1,438
Sub-total other loans	9,379
Sub-total gross loans held for investment	423,945
(Less) / Plus:	
Undisbursed construction loan funds	(26,580)
Unamortized purchase premiums, net of purchase discounts	21
Deferred loan fees and costs, net	(202)
Allowance for loan losses	(5,364)
Loans receivable held for investment, net	$391,820

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The Company serviced various types of loans for others, primarily residential mortgages, with the outstanding principal balance amounts summarized below:

	December 31,		
	2000	1999	1998
	(Dollars In Thousands)		
Loans serviced for others	$ 62,031	$ 74,225	$ 75,407

Activity in the allowance for loan losses is summarized as follows:

	Year Ended December	
	2000	1999

		(Dollars In Thousands
Balance, beginning of year	$ 3,502	$ 2,780
Provision for loan losses	2,175	835
Acquired allowance associated with Commercial Pacific Bank loans	--	--
Charge-offs:		
Residential one to four family real estate loans	(371)	(113)
Recoveries:		
Residential one to four family real estate loans	58	--
Balance, end of year	$ 5,364	$ 3,502

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MONTEREY BAY BANCORP, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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The following tables summarizes the Company's recorded investment in impaired loans by type:

	Accrual Status		Non-Accrual Status	
	Principal	Specific Allowances	Principal	Specific Allowances
			(Dollars In Thousands)	
December 31, 2000				
Residential one to four unit	$ 677	$ --	$ 603	$ --
Commercial real estate	--	--	1,133	--
Construction	--	--	2,852	600
Business term loans	--	--	78	--
Total	$ 677	$ --	$ 4,666	$ 600
December 31, 1999				
Residential one to four unit	$ 1,294	$ --	$ 543	$ --
Commercial real estate	--	--	1,146	--
Business term loans	--	--	5,000	200
Business lines of credit	--	--	199	--

Total	$ 1,294	$ --	$ 6,888	$ 200

Additional information concerning impaired loans is as follows:

	2000	1999
	(Dollars In T	
Average investment in impaired loans for the year	$ 7,790	$ 2,511
Interest recognized on impaired loans at December 31	$ 461	$ 590
Interest not recognized on impaired loans at December 31	$ 110	$ 109

Additional information concerning non-accrual loans is as follows:

	2000	1999
	(Dollars In	
Interest recognized on non-accrual loans at December 31	$ 400	$ 80
Interest not recognized on non-accrual loans at December 31	$ 110	$ 109

The Company extends loans to executive officers and directors in the ordinary course of business. These transactions were on substantially the same terms as those prevailing at the time for comparable transactions with unrelated parties and do not involve more than normal risk or unfavorable terms for the Company. An analysis of the activity of these loans is as follows:

	Year Ended December 31,	
	2000	1999
	(Dollars In Thousands)	
Balance, beginning of year	$ 631	$ 644
New loans and line of credit advances	2,119	2
Repayments	(728)	(15)
Other	(298)	--
Balance, end of period	$ 1,724	$ 631

MONTEREY BAY BANCORP, INC. AND SUBSIDIARY

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Under Office of Thrift Supervision ("OTS") regulations, the Bank may not make real estate loans to one borrower in an amount exceeding 15% of the Bank's unimpaired capital and surplus, plus an additional 10% for loans secured by readily marketable collateral. At December 31, 2000 and 1999, such limitation would have been approximately $6,520,000 and $5,329,000, respectively.

The majority of the Company's loans are secured by real estate primarily located in Santa Cruz, Monterey, Santa Clara, and San Benito counties. The Company's credit risk is therefore primarily related to the economic conditions and real estate valuations of this region. Loans are generally made on the basis of a secure repayment source, which is based on a detailed cash flow analysis; however, collateral is generally a secondary source for loan qualification. Under the Company's policy, private mortgage insurance is required for all residential real estate secured loans with an initial loan to value ratio greater than 80%.

6. INVESTMENT IN CAPITAL STOCK OF THE FEDERAL HOME LOAN BANK

As a member of the Federal Home Loan Bank of San Francisco, the Bank is required to own capital stock in an amount specified by regulation. As of December 31, 1999 and 1998, the Bank owned 28,838 and 32,131 shares, respectively, of $100 par value FHLB stock. The amount of stock owned meets the most recent annual regulatory determination.

7. ACCRUED INTEREST RECEIVABLE

Accrued interest receivable is summarized as follows:

	Decembe
	2000
	(Dollars In T
Interest receivable on cash equivalents	$ 13
Interest receivable on investment securities	102
Interest receivable on mortgage backed securities	246
Interest receivable on capital stock of the Federal Home Loan Bank	48
Interest receivable on loans	2,492
	$ 2,901

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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8. PREMISES AND EQUIPMENT

Premises and equipment consisted of the following:

	December 31, 2000	December 31, 1999
	(Dollars In Thousands)	
Land	$ 3,213	$ 3,213
Buildings and improvements	4,373	4,091
Equipment	2,832	2,340
Total, at cost	10,418	9,644
Less accumulated depreciation	(3,043)	(2,602)
Premises and equipment, net	$ 7,375	$ 7,042

Depreciation expense was $441 thousand, $472 thousand, and $456 thousand for the years ended December 31, 2000, 1999, and 1998, respectively.

9. REAL ESTATE ACQUIRED VIA FORECLOSURE

Real estate acquired by foreclosure is summarized as follows:

	December 31, 2000	December 31, 1999
	(Dollars In Thousands)	
Residential real estate acquired through foreclosure	$ --	$ 96
Less allowance for estimated real estate losses	--	--
	$ --	$ 96

At December 31, 1999, the Company's inventory of foreclosed real estate was comprised of one single family residence.

10. DEPOSITS

Deposits are as follows:

(Dollars In Thousands)	December 31, 2000	December 31, 1999
Demand deposit accounts	$ 17,065	$ 17,316
NOW accounts	41,859	31,385

Savings accounts	16,503	15,312
Money market accounts	87,651	81,245
Certificates of deposit <$100,000	166,905	169,646
Certificates of deposit $100,000 or more	77,805	52,498
	$407,788	$367,402

The following table sets forth the maturity distribution of certificates of deposit:

	December 31, 2000	
	Balance Less Than $100,000	Balance $100,000 And Over
	(Dollars In Thousands)	
Three months or less	$ 55,717	$ 40,309
Over three through six months	42,486	14,117
Over six through twelve months	38,405	14,128
Over twelve months through two years	26,157	8,803
Over two years through three years	2,639	100
Over three years	1,501	348
	$ 166,905	$ 77,805

At December 31, 2000 and 1999, respectively, total accounts with balances of $100,000 or greater in deposit products other than certificates of deposit amounted to $52,447,000 and $40,809,000.

Interest expense on deposits is summarized as follows:

	Year Ended December 31,		
	2000	1999	1998
	(Dollars In Thousands)		
NOW accounts	$ 550	$ 388	$ 227
Savings accounts	281	280	278
Money market accounts	4,040	3,402	1,716
Certificates of deposit	12,360	11,060	14,407
	$17,231	$15,130	$16,628

MONTEREY BAY BANCORP, INC. AND SUBSIDIARY

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11. ADVANCES FROM THE FEDERAL HOME LOAN BANK

The Bank is a member of the Federal Home Loan Bank ("FHLB") of San Francisco and borrows from the FHLB through various types of collateralized advances, including, at various times, bullet, amortizing, and structured advances. Assets pledged to the FHLB to collateralize advances include the Bank's ownership interest in the capital stock of the FHLB, investment and mortgage backed securities, and various types of qualifying whole loans.

A summary of advances from the FHLB and related maturities follows. All FHLB advances outstanding at December 31, 2000 and December 31, 1999 were term, bullet maturity, and non-structured advances.

	December 31,	
Year Of Maturity	2000	1999
	(Dollars In Thousands)	
2000	--	17,000
2003	25,000	25,000
2004	282	282
2005	1,500	1,500
2006	4,800	4,800
2010	1,000	1,000
	$32,582	$49,582
Weighted average nominal rate	5.48%	5.65%

Additional information concerning advances from the FHLB includes:

	2000	1999
	(Dollars In Thousands)	
Average amount outstanding during the year	$ 43,946	$ 37,600
Maximum amount outstanding at any month-end during the year	$ 50,582	$ 49,582
Weighted average interest rate during the year	5.72%	5.53%

Collateral pledged to secured advances from the FHLB is comprised of the following (amortized cost):

	December 31,	
	2000	1999
	(Dollars In Thousands)	
Mortgage backed securities	$ 18,210	$ 39,922

Capital stock in the Federal Home Loan Bank	2,884	3,213
Mortgage loans	232,604	120,598

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12. SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

From time to time, the Company sells investment and mortgage backed securities under agreements to repurchase. There were no such agreements in effect at December 31, 2000. At December 31, 1999, all such agreements matured in less than one year. The following is a summary of securities sold under agreements to repurchase during the past two years:

	Year Ended December 31,	
	2000	1999
	(Dollars In Thousands)	
Amount outstanding at the end of the year	$ --	$ 2,410
Average amount outstanding during the year	155	3,182
Maximum amount outstanding at any month-end during the year	--	4,350
Weighted average interest rate during the year	6.45%	5.65%
Weighted average interest rate at the end of the year	--	6.08%

Securities sold under agreements to repurchase are conducted with a limited list of security dealers approved and monitored by the Company. The lender maintains possession of the collateral securing these agreements.

13. LINES OF CREDIT

During the fourth quarter of 2000, Monterey Bay Bancorp, Inc. obtained a revolving line of credit from a correspondent bank of Monterey Bay Bank. The line of credit is for $2.0 million and expires on November 21, 2001. There was no balance outstanding on the line of credit at December 31, 2000. The line of credit is collateralized by five hundred thousand shares of Monterey Bay Bancorp, Inc.'s treasury stock, which is in the custody of the correspondent bank. The line of credit contains various covenants regarding the maintenance of certain financial conditions and the provision of financial and operating information. The line of credit also contains a prohibition of its use for repurchases of the Company's common stock. This line of credit provides an additional source of liquidity to the Monterey Bay Bancorp, Inc. holding company.

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MONTEREY BAY BANCORP, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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14. INCOME TAXES

The components of the provision for income taxes are as follows:

	Year Ended December 31, 2000	1999
	(Dollars In Thousands)	
Current:		
Federal	$ 1,889	$ 2,453
State	652	801
Total current	2,541	3,254
Deferred:		
Federal	(457)	(605)
State	(138)	(138)
Total deferred	(595)	(743)
Provision for income taxes	$ 1,946	$ 2,511

A reconciliation from the statutory federal income and state franchise tax rates to the consolidated effective tax rates, expressed as a percentage of income before income taxes, follows:

	Year Ended December 31, 2000	1999
	(Dollars In Thousands)	
Statutory federal income tax rate	34.0%	34.0%
California franchise tax, net of federal income tax benefit	7.6%	7.5%
Other	1.9%	1.7%
Effective income tax rate	43.5%	43.2%

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Deferred income taxes reflect the net tax effects of temporary differences, between the carrying amount of assets and liabilities for financial reporting purposes and the amount used for income tax purposes. Net deferred tax assets are included within other assets on the Consolidated Statements of Financial Condition. The tax effects of temporary differences that gave rise to significant portions of the deferred tax assets and liabilities are as follows:

	December 31,	
	2000	1999
	(Dollars In Thousands)	
Deferred tax assets:		
Allowance for loan losses	$ 1,864	$ 1,115
Intangible assets	969	835
Deferred compensation	319	485
Unrealized loss on securities available for sale	437	818
Other	75	172
Total gross deferred tax assets	3,664	3,425
Deferred tax liabilities:		
FHLB stock dividends	(419)	(392
State franchise taxes	(2)	40
Other	(64)	(108
Total gross deferred tax liabilities	(485)	(460
Net deferred tax asset	$ 3,179	$ 2,965

The Company believes that it is more likely than not that it will realize the above deferred tax assets in future periods; therefore, no valuation allowance has been provided against its deferred tax assets.

Legislation regarding bad debt recapture became law in 1996. The law requires recapture of reserves accumulated after 1987, and required that the recapture tax on post-1987 reserves be paid over a six year period starting in 1996. The Company will complete this recapture in 2001.

The Bank maintains a tax bad debt reserve of approximately $5.0 million that arose in tax years that began prior to December 31, 1987. This tax bad debt reserve will, in future years, be subject to recapture in whole or in part upon the occurrence of certain events, including, but not limited to:

o a distribution to stockholders in excess of the Bank's current and accumulated post-1951 earnings and profits

o distributions to shareholders in a partial or complete redemption or liquidation of the Bank

o the Bank ceases to be a "bank" or "thrift" as defined under the Internal

Revenue Code

The Bank does not intend to make distributions to stockholders that would result in recapture of any portion of its tax bad debt reserve if such recapture would create an additional tax liability. As a result, an associated deferred tax liability has not been recorded for the $5.0 million pre-1988 tax bad debt reserve.

15. REGULATORY CAPITAL REQUIREMENTS AND OTHER REGULATORY MATTERS

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can result in certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could present a direct material effect upon the Bank's and the Company's financial statements.

The OTS maintains regulations that require the Bank to maintain a minimum regulatory tangible capital ratio (as defined) of 1.50%, a minimum regulatory core capital ratio (as defined) of 4.00% (unless the Bank has been assigned the highest composite rating under the Uniform Financial Institutions Rating System, in which case 3.00%), and a regulatory risk based capital ratio (as defined) of 8.00%. The following table presents a reconciliation as of December 31, 2000 and 1999, between the Bank's capital under accounting principles generally accepted in the United States of America ("GAAP") and regulatory capital as presently defined under OTS regulations, in addition to a review of the Bank's compliance with OTS capital requirements:

(Dollars In Thousands)

	Tangible Capital		Core (Tier One) Capital	
As Of December 31, 2000	Amount	Percent	Amount	Percent
Capital of the Bank presented on a GAAP basis	$ 40,274		$ 40,274	
Adjustments to GAAP capital to derive regulatory capital:				
Net unrealized loss on debt securities classified as available for sale	624		624	
Non-qualifying intangible assets	(2,195)		(2,195)	
Qualifying general allowance for loan losses	--		--	
Bank regulatory capital	38,703	8.03%	38,703	8.03%
Less minimum capital requirement	7,227	1.50%	19,272	4.00%

Regulatory capital in excess of minimums	$ 31,476	6.53%	$ 19,431	4.03%

Additional information:

Bank regulatory total assets	$ 481,795
Bank regulatory risk based assets	$ 351,038

(Dollars In Thousands)

As Of December 31, 1999	Tangible Capital Amount	Tangible Capital Percent	Core (Tier One) Capital Amount	Core (Tier One) Capital Percent
Capital of the Bank presented on a GAAP basis	$ 34,022		$ 34,022	
Adjustments to GAAP capital to derive regulatory capital:				
Net unrealized loss on debt securities classified as available for sale	1,123		1,123	
Non-qualifying intangible assets	(2,918)		(2,918)	
Qualifying general allowance for loan losses	--		--	
Bank regulatory capital	32,227	7.11%	32,227	7.11%
Less minimum capital requirement	6,800	1.50%	18,134	4.00%
Regulatory capital in excess of minimums	$ 25,427	5.61%	$ 14,093	3.11%

Additional information:

Bank regulatory total assets	$ 453,345
Bank regulatory risk based assets	$ 336,323

Federal thrift institutions such as the Bank are also subject to various provisions of the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA"). Among these provisions are requirements for prompt corrective action in the event an insured institution fails to meet certain regulatory capital thresholds. The prompt corrective action regulations define five specific capital categories based upon an institution's regulatory capital ratios. These five capital categories, in declining order, are "well capitalized", "adequately capitalized", "undercapitalized", "significantly undercapitalized", and "critically undercapitalized". Institutions categorized as "undercapitalized" or worse are subject to certain restrictions, including the requirement to file a capital plan with the OTS, prohibitions on the payment of dividends and management fees, restrictions on executive compensation, and increased supervisory monitoring, among other things. Other restrictions may be imposed on the institution either by the OTS or by the FDIC, including requirements to raise additional capital, sell assets, or sell the entire institution.

As of December 31, 2000 and 1999, the most recent notification from the OTS categorized the Bank as "well capitalized" under the regulatory framework for prompt corrective action. To be categorized as "well capitalized", the Bank must maintain minimum core capital, tier one risk based, and total risk based capital ratios as presented in the following table. There are no conditions or events since that notification that management believes have changed the Bank's category.

	Actual		For Capital Adequacy Purposes	
As Of December 31, 2000	Amount	Ratio	Amount	Ratio
Total Capital (to risk weighted assets)	$ 43,096	12.28%	$ 28,083	8.00%
Tier One Capital (to risk weighted assets)	38,703	11.03%	N/A	N/A
Core Capital (to adjusted tangible assets)	38,703	8.03%	19,272	4.00%
Tangible Capital (to tangible assets)	38,703	8.03%	7,227	1.50%
As Of December 31, 1999				
Total Capital (to risk weighted assets)	$ 35,529	10.56%	$ 26,906	8.00%
Tier One Capital (to risk weighted assets)	32,227	9.58%	N/A	N/A
Core Capital (to adjusted tangible assets)	32,227	7.11%	18,134	4.00%
Tangible Capital (to tangible assets)	32,227	7.11%	6,800	1.50%

The above amounts for December 31, 2000 and 1999 reflect a 100% risk-based capital category classification for a specific portfolio of residential mortgage loans, as discussed below.

At December 31, 2000, the Bank was under institution specific requirements from the OTS that regulatory capital ratios not decline below their levels at December 31, 1999. At December 31, 2000, the Bank was in compliance with these institution specific requirements and maintained $4.4 million in regulatory capital in excess of these institution specific requirements.

Management believes that, under current regulations, the Bank will continue to meet its minimum capital requirements in the coming year. However, events beyond the control of the Bank, such as changing interest rates or a downturn in the economy and / or real estate markets where the Bank maintains most of its loans, could adversely affect future earnings and, consequently, the ability of the Bank to meet its future minimum regulatory capital requirements.

OTS rules impose certain limitations regarding stock repurchases and redemptions, cash-out mergers, and any other distributions charged against an institution's capital accounts. The payment of dividends by Monterey Bay Bank to

Monterey Bay Bancorp, Inc. is subject to OTS regulations. "Safe-harbor" amounts of capital distributions can be made after providing notice to the OTS, but without needing prior approval. For Tier 1 institutions such as the Bank, the safe harbor amount is the greater of (1) net income earned during the year or (2) the sum of net income earned during the year plus one-half of the institution's capital in excess of the OTS capital requirement as of the end of the prior year. Distributions beyond these amounts are allowed only with the specific, prior approval of the OTS. In addition, the Bank must continue to comply with the institution specific regulatory capital requirements in paying any dividends.

Special Residential Loan Pool

During 1998, the Bank purchased a $40.0 million residential mortgage pool comprised of loans that presented a borrower credit profile and / or a loan to value ratio outside of (less favorable than) the Bank's normal underwriting criteria. To mitigate its credit risk for this portfolio, concurrent with the purchase, the Bank obtained a scheduled principal / scheduled interest loan servicing agreement from the seller. Further, this agreement also contains a guaranty by the seller to absorb any principal losses on the portfolio in exchange for the seller's retention of a portion of the loans' yield through loan servicing fees. As a result of obtaining these credit enhancements, the Bank functionally aggregated the credit risk for this loan pool into a single borrower credit risk to the seller / servicer of the loans. The Bank was subsequently informed by the OTS that structuring the purchase in this manner made the transaction an "extension of credit" by the Bank to the seller / servicer, which, by virtue of its size, violated the OTS' "Loans To One Borrower" regulation.

At December 31, 2000, the outstanding principal balance of this mortgage loan pool was $16.5 million, with an additional $3.2 million in December payoffs received from the seller / servicer in January, 2001. While the seller / servicer met all its contractual obligations through December 31, 2000, the Company has allocated certain general loan loss reserves due to concerns regarding the potential losses by the seller / servicer in honoring the guaranty, the present delinquency profile of the special residential mortgage pool, and the differential between certain loan principal balances for foreclosed loans and loans in the process of foreclosure and the estimated amounts to be recovered from the sales of such properties.

Because the seller / servicer provides scheduled principal and interest payments regardless of the actual payment performance of the loans and because the seller / servicer absorbs all losses on the disposition of associated foreclosed real estate, the Company reports all loans within the special residential loan pool as performing; with the allocation of certain general loan loss reserves to this pool.

By December 31, 2000, all of the loans in the special residential loan pool converted from an initial fixed rate that was maintained for the first two years of the loan to an adjustable rate significantly above current market rates for medium to high credit quality residential mortgages. The weighted average gross interest rate on the special residential loan pool at December 31, 2000 was 11.44%. The differential between the interest rates on the loans and available refinance rates contributed to significant prepayments during 2000.

Management believes additional prepayments are likely to occur in 2001. However, management also believes that there will be some loans that will not refinance in the next year due to a lack of available financing for less creditworthy borrowers or because of borrower inaction. By the end of 2001, the Company may therefore be particularly dependent upon the financial strength and continued performance of the seller / servicer, as the remaining portfolio is expected to be comprised of relatively less creditworthy loans while at the same time having a smaller total principal balance outstanding and thereby providing less periodic cash flow to the seller / servicer via the retained servicing spread.

In conjunction with this Special Residential Loan Pool, on March 6, 2000, the Bank received a letter from the OTS mandating that the Bank (i) assign all of the loans in the pool a 100% risk based capital weighting, and (ii) not permit its regulatory capital ratios to decline below the levels existing at December 31, 1999. Management does not foresee any compliance issue with this request given the Bank's regulatory capital position at December 31, 2000 and due to the expected continued generation of regulatory capital through retained earnings, the amortization of deferred stock compensation, and the amortization of intangible assets.

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16. COMMITMENTS AND CONTINGENCIES

The Company is involved in certain legal proceedings arising in the normal course of business. In the opinion of management, the outcomes of such proceedings should not have a material adverse effect on the Company's financial position or results of operations.

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments represent commitments to originate fixed and variable rate loans, letters of credit, lines of credit, and loans in process, and involve, to varying degrees, elements of interest rate risk and credit risk in excess of the amount recognized in the Consolidated Statements of Financial Condition. The Company uses the same credit policies in making commitments to originate loans, lines of credit, and letters of credit as it does for on-balance sheet instruments.

At December 31, 2000, the Company had outstanding commitments to originate $5.7 million of real estate loans, including $284 thousand for fixed rate loans and $5.4 million for adjustable rate loans. At December 31, 2000, the Company also had outstanding commitments to originate $710 thousand in commercial business loans. Commitments to fund loans are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have expiration dates or other termination clauses. In addition, external market forces may impact the probability of commitments being exercised; therefore, total commitments outstanding do not necessarily represent future cash requirements.

At December 31, 2000, the Company had made available various business, personal, and residential lines of credit totaling approximately $15.6 million, of which the undisbursed portion was approximately $6.8 million.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. At December 31, 2000, the Company maintained outstanding letters of credit totaling $136 thousand, compared to $2.0 million at December 31, 1999.

At December 31, 2000, the Company had recourse liability on $1.5 million of sold residential loans. No losses stemming from this recourse liability were recorded during 2000. Management includes a consideration of this recourse liability in establishing the allowance for loan losses.

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At December 31, 2000, 1999, and 1998, the Company was obligated under non-cancelable operating leases for office space. Certain leases contain escalation clauses providing for increased rentals based primarily on increases in real estate taxes or on the average consumer price index. Rent expense under operating leases, included in occupancy and equipment expense, was approximately $133 thousand, $121 thousand, and $170 thousand for the years ended December 31, 2000, 1999, and 1998, respectively.

Certain branch offices are leased under the terms of operating leases expiring at various dates through the year 2005. At December 31, 2000, future minimum rental commitments under non-cancelable operating leases were as follows:

	(Dollars In Thousands)
2001	$ 134
2002	134
2003	111
2004	62
2005	31
Thereafter	--
Total	$ 472

In the normal course of business, the Company and Bank have negotiated employment agreements with the Chief Executive Officer / President and the Chief Financial Officer.

In addition, at December 31, 2000, the Company and Bank also maintained change in control agreements with six officers. These agreements result in severance payments following certain events associated with a change in control of the Company or the Bank.

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17. EARNINGS PER SHARE

The Company calculates Basic and Diluted Earnings Per Share ("EPS") in accordance with SFAS No. 128, Earnings Per Share. Basic EPS are computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding during each period. During the years 1998 through 2000, all of the Company's net income was available to common stockholders. The weighted average number of common shares outstanding for the Company is decreased in each reporting period by:

- o shares associated with the Company's ESOP which have not been committed to be released

- o shares associated with the Company's stock grant programs which are not yet vested to Plan participants

- o the weighted average number of Treasury shares maintained by the Company during each period

The computation of Diluted EPS also considers, via the treasury stock method of calculation, the impact of shares issuable upon the assumed exercise of outstanding stock options (both incentive stock options and non-statutory stock options) and stemming from the grant of time-based stock awards under the Company's associated Plans for officers and directors. In calculating diluted earnings per share, no anti-dilutive calculations are permitted and diluted share counts are applicable only in the event of positive earnings. For the years 1998 through 2000, there was no difference in the Company's income used in calculating basic and diluted earnings per share.

The following table reconciles the calculation of the Company's Basic and Diluted EPS for the periods indicated.

	For The Year Ended	
(In Whole Dollars And Whole Shares)	2000	1999
Net income	$ 2,523,000	$ 3,301,000
Average shares issued	4,492,085	4,492,085
Less weighted average:		
Uncommitted ESOP shares	(161,719)	(197,657
Non-vested stock award shares	(60,612)	(88,689
Treasury shares	(1,158,844)	(974,577
Sub-total	(1,381,175)	(1,260,923
Weighted average BASIC shares outstanding	3,110,910	3,231,162
Add dilutive effect of:		
Stock options	12,483	83,730
Stock awards	159	5,286
Sub-total	12,642	89,016
Weighted average DILUTED shares outstanding	3,123,552	3,320,178

Earnings per share:

BASIC	$ 0.81	$ 1.02
	======	======
DILUTED	$ 0.81	$ 0.99
	======	======

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MONTEREY BAY BANCORP, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2000, 1999, AND 1998 (Continued)

18. OTHER COMPREHENSIVE INCOME

The Company's only source of other comprehensive income has been derived from unrealized gains and losses on the portfolios of investment and mortgage backed securities classified as available for sale.

Reclassification adjustments for the change in net gains (losses) included in other comprehensive income from investment and mortgage backed securities classified as available for sale during the past three years are summarized as follows:

	Year Ended Dece	
	2000	1999
	(Dollars In Th	
Gross reclassification adjustment	$ (55)	$ 496
Tax benefit (expense)	23	(204
Reclassification adjustment, net of tax	$ (32)	$ 292

A reconciliation of the net unrealized gain or loss on available for sale securities recognized in other comprehensive income is as follows:

	Year Ended Dece	
	2000	1999
	(Dollars In Th	
Holding gain (loss) arising during the year, net of tax	$ 513	$ (1,671
Reclassification adjustment, net of tax	32	(292
Net unrealized gain (loss) recognized in other comprehensive income	$ 545	$(1,963

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19. STOCK BENEFIT PLANS

Stock Option Programs - On August 24, 1995, the stockholders of the Company approved the 1995 Incentive Stock Option Plan (the "Stock Option Plan"). Under the Stock Option Plan, the Company may grant to officers and employees of the Company and its affiliate, the Bank, both non-statutory and incentive stock options, as defined under the Internal Revenue Code, to purchase shares of the Company's common stock.

On August 24, 1995, the stockholders of the Company also approved the 1995 Stock Option Plan For Outside Directors (the "Directors Option Plan"). Under the Directors' Option Plan, directors who are not officers or employees of the Company or Bank may be granted non-statutory stock options to purchase shares of the Company's common stock.

On May 25, 2000, the stockholders of the Company approved amendments to the Stock Option Plan. These amendments included:

- an increase in the number of shares reserved for issuance under the Stock Option Plan from 414,107 shares to 660,000 shares

- an increase in the strike price of options granted under the Stock Option Plan from not less than 100% of the fair market value of the common stock on the date of grant (except that the exercise price for beneficial owners of more than 10.0% of the outstanding voting stock of the Company must be equal to 110% of the fair market value of the common stock on the date of grant) to at least 110% of the fair market value of the common stock on the date of grant for all grants occurring on or after May 25, 2000

- providing additional flexibility in the vesting schedule for both incentive stock options and non-statutory stock options

- allowing non-employee directors to be eligible for the grant of non-statutory stock options under the Stock Option Plan

Options granted under the Stock Option Plan prior to May 25, 2000 entitle the holder to purchase one share of the common stock at the fair market value of the common stock on the date of grant. Options granted under the Stock Option Plan prior to May 25, 2000 begin to vest one year after the date of grant ratably over five years and expire no later than ten years after the date of grant.

Options granted under the Stock Option Plan after May 24, 2000 entitle the holder to purchase one share of the common stock at 110% of the fair market value of the common stock on the date of grant. Options granted under the Stock Option Plan after May 24, 2000 vest at various times as specified under each individual option agreement and expire no later than ten years after the date of grant.

Options granted under the Directors Option Plan entitle the holder to purchase one share of the common stock at the fair market value of the common stock on the date of grant. Options begin to vest one year after the date of grant ratably over five years and expire no later than ten years after the date of grant.

As of December 31, 2000, no stock options under either the Stock Option Plan or the Directors Option Plan were granted to an individual owning common stock representing more than 10.0% of the total combined voting power of the Company's common stock.

All options under the Stock Option Plan become 100% exercisable in the event that the employee terminates his employment due to death, disability, or, to the extent not prohibited by the OTS, in the event of a change in control of the Company or the Bank.

All options under the Directors Option Plan become 100% exercisable in the event that the director terminates membership on the board of directors due to death, disability, or, to the extent not prohibited by the OTS, in the event of a change in control of the Company or the Bank.

The Company applies Accounting Principles Board ("APB") Opinion No. 25 and related interpretations in accounting for stock options. Under APB No. 25, compensation cost for stock options is measured as the excess, if any, of the fair market value of the Company's stock at the date of grant over the amount the employee or director must pay to acquire the stock. Because the Company's stock option Plans provide for the issuance of options at a price of no less than the fair market value at the date of grant, no compensation cost is required to be recognized for the stock option Plans.

Had compensation costs for the stock option Plans been determined based upon the fair value at the date of grant consistent with SFAS No. 123, Accounting For Stock Based Compensation, the Company's net income and earnings per share would have been reduced to the pro forma amounts indicated below. The pro forma amounts presented below were calculated utilizing the Black-Scholes option pricing model, with forfeitures recognized as they occur, incorporating the assumptions detailed on the following page.

	Year Ended December 31,	
	2000	1999
	(Dollars In Thousands, Except Sha	
Net income:		
As reported	$ 2,523	$ 3,301
Pro forma	$ 2,223	$ 3,022
Basic earnings per share:		
As reported	$ 0.81	$ 1.02
Pro forma	$ 0.71	$ 0.94
Diluted earnings per share:		
As reported	$ 0.81	$ 0.99
Pro forma	$ 0.71	$ 0.91
Shares utilized in Basic EPS calculations	3,110,910	3,231,162
Shares utilized in Diluted EPS calculations	3,123,552	3,320,178

The original number of stock options allowed under the Stock Option Plan in 1995 was 351,758 shares. Pursuant to the terms of the Stock Option Plan, the Board of Directors authorized increases in allowable shares of 28,123 in 1998 and 34,226 in 1999. On May 25, 2000, stockholders approved an increase in allowable shares to 660,000.

The original number of stock options allowed under the Directors Option Plan in 1995 was 97,929 shares. This figure has not changed since the initial adoption of the Directors Option Plan.

The status of the aggregate stock options under the two Plans as of December 31, 2000, 1999, and 1998, and changes during the years then ended, are presented below. The abbreviation "FMV" represents "fair market value".

	December 31,			
	2000		1999	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Options outstanding at the beginning of the year	362,597	$10.30	418,311	$10.38
Granted	197,865	$10.00	5,000	$14.75
Canceled	10,226	$10.49	26,932	$13.59
Exercised	--	$ --	33,782	$9.40
Options outstanding at year end	550,236	$10.19	362,597	$10.30
Options outstanding at year end:				
Granted at 100% FMV	464,236	$10.04		
Granted at 110% FMV	86,000	$10.98		
Options exercisable at year end:				
Granted at 100% FMV	308,262	$9.65	239,853	$9.51
Granted at 110% FMV	17,240	$11.76	--	
Total	325,502	$9.76	239,853	$9.51
Options available for future grants	127,543		69,289	
Weighted average remaining contractual life of options outstanding at year end	6.6 years		6.2 years	
Weighted average information for				

options granted during the year at 100% of FMV:		
Fair value	$4.68	$7.76
Weighted average information for options granted during the year at 110% of FMV:		
Fair value	$4.41	--
Assumptions utilized in the Black-Scholes option-pricing model (for all options granted each year)		
Dividend Yield	0.00%	1.00%
Expected stock price volatility	35.00%	45.00%
Average risk-free interest rate	6.11%	5.73%
Expected option lives	8 years	8 years

The following table summarizes information about the stock options outstanding at December 31, 2000:

Options Granted At 100% Of Fair Market Value:

Exercise Price	Number Outstanding	Weighted Average Remaining Life In Years	Number Exercisable
$ 8.19	45,000	9.3	0
$ 9.10	274,090	4.6	274,090
$ 9.69	26,865	9.2	0
$10.13	40,000	9.1	0
$10.70	9,658	5.5	7,726
$14.75	5,000	8.5	1,000
$14.80	56,250	7.5	22,500
$16.60	7,373	7.2	2,946
$8.19 - $16.60	464,236	6.2	308,262

Options Granted At 110% Of Fair Market Value:

Weighted

Exercise Price	Number Outstanding	Average Remaining Life In Years	Number Exercisable
$ 9.77	12,500	9.6	0
$ 9.90	10,000	9.4	0
$11.21	43,500	9.9	0
$11.76	20,000	5.7	17,240
$9.77 - $11.76	86,000	8.8	17,240
TOTAL	550,236	6.6	325,502

MONTEREY BAY BANCORP, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2000, 1999, AND 1998 (Continued)

Stock Award Programs - The Company maintains a Performance Equity Program ("PEP") for officers and employees. In addition, prior to the end of 2000, the Company maintained a Recognition and Retention Plan for Outside Directors ("RRP"). The Company accelerated the vesting of the remaining RRP shares, distributed the remaining shares, and terminated the RRP during 2000. These two stock award Plans (PEP and RRP) were designed to provide directors, officers, and employees with a proprietary interest in the Company in a manner designed to encourage such persons to remain with the Company and to improve the financial performance of the Company.

The Bank contributed $1.7 million during the fourth quarter of 1995 and the first quarter of 1996 to purchase 179,687 shares of Company common stock in the open market at a weighted average cost of $9.62 per share. This contribution was initially recorded as a reduction in stockholders' equity and then is ratably charged to compensation expense over the vesting period of the actual stock awards. Of the 179,687 shares acquired, 38,010 were allocated to the RRP, with the remaining 141,677 allocated to the PEP.

The PEP provides for two types of stock awards: time-based grants and performance-based grants. Time-based grants vest pro-rata on each anniversary of the grant date and become fully vested over the applicable time period as determined by the board of directors, typically five years. Vesting of performance-based grants is dependent upon achievement of criteria established by the board of directors for each stock award. Under the RRP, outside directors of the Company received exclusively time-based grants.

All stock awards granted will be immediately vested in the event the recipient terminates his employment (or in the case of a director, his service, including service as a Director Emeritus) due to death, disability, or a change in control of Monterey Bay Bank or Monterey Bay Bancorp, Inc. In the event the award recipient terminates his employment or service due to any reason other than death, disability, or a change in control, all unvested stock awards become null and void. In addition, to the extent that criteria for performance-based stock awards are not achieved, associated awards are forfeited and become available for re-issuance.

Periodic operating expense for time-based stock awards is recognized based upon fair market value at date of grant. Periodic operating expense for performance-based stock awards is recognized based upon fair market value at the earlier of the reporting date or the performance measurement date.

During 2000, the Company utilized previously unallocated shares under the PEP to compensate certain employees for their favorable performance. These shares were granted in lieu of cash incentive compensation and vested immediately.

A summary of the PEP as of December 31, 2000, 1999, and 1998, and changes and related expense during the years ended on those dates, is presented below:

	2000	19
Stock awards outstanding at the beginning of the year	30,864	56,7
Stock award activity during the year:		
Time based shares granted	11,576	
Performance based shares granted	18,168	
Performance based shares granted in lieu of cash compensation	3,160	
Performance based shares immediately vested upon grant	(3,160)	
Time based shares canceled	--	(1,4
Performance based shares canceled	(1,129)	(4,7
Time based shares vested	(11,860)	(12,6
Performance based shares vested	(12,540)	(7,0
Stock awards outstanding at the end of the year	35,079	30,8
Available for future awards at the end of the year	--	31,7
PEP compensation expense (In Whole Dollars)	$229,771	$227,0

A summary of the status of the RRP as of December 31, 2000, 1999, and 1998, and changes and related expense during the years ended on those dates, is presented below:

	2000	1999
Stock awards outstanding at the beginning of the year	9,541	16,588
Stock award activity during the year:		
Time based shares granted	--	--

Time based shares canceled	--	--
Time based shares vested	(9,541)	(7,047)
Stock awards outstanding at the end of the year	--	9,541
Available for future awards at the end of the year	--	--
RRP compensation expense (In Whole Dollars)	$66,349	$70,042

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MONTEREY BAY BANCORP, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2000, 1999, AND 1998 (Continued)

Employee Stock Ownership Plan and Trust - The Company established for eligible employees an Employee Stock Ownership Plan and Trust ("ESOP"), which became effective upon the conversion of the Bank from a mutual to a stock association. Eligible full-time employees employed with the Bank who have been credited with at least 1,000 hours during a twelve month period, have attained age twenty-one, and were employed on the last business day of the calendar year are eligible to participate.

The ESOP subscribed for 8.0% (or 359,375) of the shares of Company common stock issued in the Conversion at an adjusted price of $6.40 per share. On February 14, 1995, the ESOP borrowed $2.3 million from Monterey Bay Bancorp, Inc. in order to fund the purchase of the common stock. This loan is being repaid pro-rata over an approximately ten year period concluding on December 31, 2004, with the funds for repayment primarily coming from the Bank's contributions to the ESOP over a similar time period. The loan is collateralized by the shares of common stock held by the ESOP.

As an internally leveraged ESOP, no interest income or interest expense is recognized on the loan in the consolidated financial statements of the Company. Annual principal payments of $230,000 are scheduled for the conclusion of each calendar year in conjunction with a release of shares for allocation to individual employee accounts. Shares are allocated on the basis of eligible compensation, as defined in the ESOP plan document, in the year of allocation. Benefits generally become 100% vested after seven years of credited service. Employees with at least three, but fewer than seven, years of credited service receive a partial vesting according to a sliding schedule. However, in the event of retirement, disability, or death, any unvested portion of benefits shall vest immediately. Any share forfeitures are allocated among participating employees in the same proportion as annual share allocations. Benefits are payable upon separation from service based on vesting status and share allocations made.

As of December 31, 2000, 215,625 shares were allocated to participants and committed to be released. As of December 31, 2000, the fair market value of the 143,750 unearned shares was $1.5 million based upon a closing market price per share of $10.69. The outstanding ESOP loan balance, which is not a component of the Company's consolidated financial statements, was $920 thousand at December 31, 2000.

Periodic operating expense associated with the ESOP is recognized based upon:

- the number of Company common shares pro-rata allocated
- the fair market value of the Company's common stock at the dates shares are committed to be released
- any dividends received on unallocated shares as a reduction to periodic operating expense

The benefits expenses, not including administrative costs, related to the ESOP for the years ended December 31, 2000, 1999, and 1998 were $317 thousand, $454 thousand, and $526 thousand, respectively. At December 31, 2000 and 1999, the unearned compensation related to the ESOP was $920 thousand and $1.15 million, respectively. These amounts are shown as a reduction of stockholders' equity in the Consolidated Statements Of Financial Condition.

20. 401(K) PLAN

The Company maintains a tax deferred employee savings plan under Section 401(k) of the Internal Revenue Code. All employees are eligible to participate who are 21 years of age, have been employed by the Company for at least 90 days, and are scheduled to complete 1,000 hours of service or more per calendar year. The Company does not provide periodic or matching contributions to the 401(k) Plan. However, the Plan contains a profit sharing component under which the Company may elect to contribute. Through December 31, 2000, the Company has not made such an election.

The trust that administers the 401(k) Plan had assets of approximately $1.8 million and $1.9 million as of December 31, 2000 and 1999, respectively. None of these assets have been maintained at the Company or its subsidiary.

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21. OFFICERS SALARY CONTINUATION PLAN

The Company historically maintained a non-qualified Salary Continuation Plan for the benefit of certain officers of the Bank. Officers participating in the Plan are entitled to receive a fixed monthly payment for a period of ten years upon retirement. The Plan provides that payments will be accelerated upon the death of the Participant or in the event of a change in control of Monterey Bay Bancorp, Inc. or Monterey Bay Bank. The Plan was closed to new participants in 1999. In addition, during 1999, the Plan was amended to allow participants to make an irrevocable election to convert their benefits into shares of Company common stock.

As a non-qualified Plan, no Company assets are segregated to meet the future obligations of the Company. Plan participants are general creditors of the Company.

During 2000, the Company offered a lump sum settlement to all remaining Plan participants in order to eliminate future periodic administrative costs associated with the Plan. All but two participants elected to receive a lump sum distribution. Such distributions were effected in either cash or Company common stock, as applicable, prior to the end of 2000.

At December 31, 2000, the Company maintained an accrued liability of $238 thousand, included in other liabilities, related to its cash payment obligations to the remaining two participants in the Plan, both of whom are currently receiving periodic cash payments. This figure represents the present value of the future payments due to the participants discounted at 5.0%.

At December 31, 1999, the Company designated 3,098 shares of common stock in conjunction with its obligation to provide benefits in the form of Company common stock and an accrued liability of $256 thousand for future cash benefits payable under the Plan.

Periodic expense associated with the Plan was $3 thousand in 2000, $44 thousand in 1999, and $19 thousand in 1998.

Payment obligations by the Company under the Plan as of December 31, 2000 extend through October, 2007.

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22. DIRECTORS RETIREMENT PLAN

The Company historically maintained a non-qualified Directors Retirement Plan for the benefit of certain directors of the Bank. Under this Plan, directors of the Bank who have served on the board of directors for a minimum of nine years are entitled to receive a quarterly payment equal to the amount of the quarterly retainer fee in effect at the date of retirement, continuing for a period of ten years. The Plan provides that payments will be accelerated upon the death of the participant or in the event of a change in control of the Monterey Bay Bancorp, Inc. or Monterey Bay Bank. The Plan was closed to new participants in 1999. In addition, during 1999, the Plan was amended to allow participants to make an irrevocable election to convert their benefits into shares of Company common stock.

As a non-qualified Plan, no Company assets are segregated to meet the future obligations of the Company. Plan participants are general creditors of the Company.

During 2000, the Company offered a lump sum settlement to all remaining Plan participants in order to eliminate future periodic administrative costs associated with the Plan. All but two participants elected to receive a lump sum distribution. Such distributions were effected in either cash or Company common stock, as applicable, prior to the end of 2000.

At December 31, 2000, one of the two remaining participants had elected to receive a lump sum distribution in 2001 in satisfaction of the Company's obligations to him under the Plan. The heirs of the other remaining Plan participant at December 31, 2000 are receiving periodic cash payments under the Plan. At December 31, 2000, the Company maintained an accrued liability of $122 thousand included in other liabilities related to its cash payment obligations. This figure represents the present value of the future payments due to the participants discounted at 5.0%

At December 31, 1999, the Company maintained 29,788 shares related to its obligations to participants under the Plan. At December 31, 1999, the Company maintained an accrued liability of $196 thousand related to its cash payment obligations under the Plan.

Periodic expense associated with the Plan was $3 thousand in 2000, $68 thousand in 1999, and $33 thousand in 1998.

Payment obligations by the Company under the Plan as of December 31, 2000 extend through March, 2004.

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23. PARENT COMPANY ONLY CONDENSED FINANCIAL INFORMATION

The Parent Company and its subsidiary, the Bank, file consolidated federal income tax returns in which the taxable income or loss of the Parent Company is combined with that of the Bank. The Parent Company's share of income tax expense is based on the amount which would be payable if separate returns were filed. Accordingly, the Parent Company's equity in the net income of its subsidiaries (distributed and undistributed) is excluded from the computation of the provision for income taxes for stand alone financial statement purposes.

The condensed financial statements of Monterey Bay Bancorp, Inc. (parent company only) are as follows:

CONDENSED STATEMENTS OF FINANCIAL CONDITION

	December 31,	
	2000	1999
	(Dollars In Thousands)	
ASSETS:		
Cash and due from depository institutions	$ 558	$ 62
Overnight deposits	3,210	100
Total cash & cash equivalents	3,768	162
Mortgage-backed securities available for sale	--	3,750
Loan receivable, net	--	4,800
Other assets	51	524
Investment in subsidiary	40,274	34,022
TOTAL ASSETS	$44,093	$43,258
LIABILITIES AND STOCKHOLDERS' EQUITY:		
Liabilities:		
Securities sold under agreements to repurchase	$ --	$ 2,410
Other liabilities	256	45
Total Liabilities	256	2,455
Stockholders' equity	43,837	40,803

TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$44,093	$43,258

MONTEREY BAY BANCORP, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2000, 1999, AND 1998 (Continued)

CONDENSED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME

	Year Ended	
	2000	
	(Dollars In	
Interest income:		
Interest on mortgage backed securities and investment securities	$ 19	$
Interest on loan receivable	560	
Other interest income	46	
Total interest income	625	
Interest expense:		
Interest on securities sold under agreements to repurchase	10	
Other borrowings	21	
Total interest expense	31	
Net interest income before (benefit) provision for loan losses	594	
(Benefit) provision for loan losses	(200)	
Net interest income after (benefit) provision for loan losses	794	
Loss on sale of mortgage backed securities available for sale	79	
Non-interest expense	817	
Income before (benefit) provision for income taxes	(102)	
(Benefit) provision for income taxes	(42)	
(Loss) income before undistributed net income of subsidiary	(60)	
Undistributed net income of subsidiary	2,583	3
Net income	$2,523	$3
Other comprehensive income (loss)	545	(1

Comprehensive income	$3,068	$1
	======	==

MONTEREY BAY BANCORP, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2000, 1999, AND 1998 (Continued)

CONDENSED STATEMENTS OF CASH FLOWS

	Year Ended D	
	2000	
	(Dollars In	
OPERATING ACTIVITIES:		
Net income	$ 2,523	$ 3
Adjustments to reconcile net income to net cash provided by operating activities:		
Undisbursed net income of subsidiary	(2,583)	(3
Amortization of premiums on securities	--	
(Benefit) provision for loan losses	(200)	
Loss on sale of securities	79	
Cash receipts associated with ESOP	460	
Decrease (increase) in other assets	473	
Other, net	(44)	
Net cash provided by operating activities	708	
INVESTING ACTIVITIES:		
Loans originated	--	
Proceeds from repayments of loans	5,000	
Dividend from subsidiary	--	
Investment in subsidiary	(2,100)	
Principal repayments on mortgage backed securities available for sale	49	2
Proceeds from sales of mortgage backed securities available for sale	3,702	
Proceeds from maturities of investment securities	--	
Net cash provided by investing activities	6,651	2
FINANCING ACTIVITIES:		
Repayments from reverse repurchase agreements, net	(2,410)	(2
Cash dividends paid to stockholders	(274)	
Sales of treasury stock	182	
Purchases of treasury stock	(1,251)	(1

Net cash used in financing activities	(3,753)	(3
NET INCREASE (DECREASE) IN CASH & CASH EQUIVALENTS	3,606	
CASH & CASH EQUIVALENTS AT BEGINNING OF YEAR	162	1
CASH & CASH EQUIVALENTS AT END OF YEAR	$ 3,768	$

24. ESTIMATED FAIR VALUES OF FINANCIAL INSTRUMENTS

The estimated fair value amounts have been determined by the Company, using available market information and appropriate valuation methodologies. However, considerable judgement is required to interpret market data to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Company could realize in a current market exchange. The use of different assumptions and / or estimation methodologies may have a material effect on the estimated fair value amounts.

The following methods and assumptions were used by the Company in computing the estimated fair values:

Cash And Cash Equivalents - Current carrying amounts approximate estimated fair value.

Capital Stock Of The Federal Home Loan Bank - Fair value is based upon its redemption value, which equates to current carrying amounts.

Investment Securities and Mortgage Backed Securities - Fair values of these securities are based on year-end market prices or dealer quotes. If quoted market prices are not available, estimated fair values were based upon quoted market prices of comparable instruments.

Loans Receivable Held For Investment - For fair value estimation purposes, these loans have been categorized by type of loan (e.g., one to four unit residential) and then further segmented between adjustable or fixed rates. Where possible, the fair value of these groups of loans has been based on secondary market prices for loans with similar characteristics. The fair value of the remaining loans has been estimated by discounting the future cash flows using current interest rates being offered for loans with similar remaining terms to borrowers of similar credit quality. Prepayment estimates were based on historical experience and published data for similar loans.

Transaction Deposit Accounts - The estimated fair value of checking, savings, and money market deposit accounts is the amount payable on demand at the reporting dates.

Certificates Of Deposit - Fair value has been estimated by discounting the contractual cash flows using current market rates offered in the Company's market area for similar time deposits with comparable remaining terms.

FHLB Advances - Fair value was estimated by discounting the contractual cash flows using current market rates offered for advances with comparable conditions and remaining terms.

Securities Sold Under Agreements To Repurchase - Fair value was estimated by discounting the contractual cash flows using current market rates offered for borrowings with comparable conditions and remaining terms.

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MONTEREY BAY BANCORP, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2000, 1999, AND 1998 (Continued)

Commitments To Extend Credit - The estimated fair values of commitments to fund loans are estimated using the fees currently charged to enter into similar agreements, considering the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed rate loan commitments, the estimated fair values also incorporate the difference between current levels of interest rates for similar commitments and the committed rates.

Standby Letters Of Credit - The estimated fair values of standby letters of credit were determined by using the fees currently charged taking into consideration the remaining terms of the agreements and the creditworthiness of the counterparties.

The carrying amounts and estimated fair values of the Company's financial instruments are as follows:

	December 31, 2000		
	Carrying Amount	Estimated Fair Value	C
		(Dollars In Thous	
ASSETS:			
Cash and cash equivalents	$ 25,159	$ 25,159	$
Investment securities available for sale	7,360	7,360	
Mortgage backed securities available for sale	42,950	42,950	
Mortgage backed securities held to maturity	--	--	
Loans receivable held for investment, net	391,820	398,257	
FHLB stock	2,884	2,884	
LIABILITIES:			
Transaction deposit accounts	163,078	163,078	
Certificates of deposit	244,710	244,400	
Advances from the Federal Home Loan Bank	32,582	32,501	
Securities sold under agreements to repurchase	--	--	
OFF-BALANCE SHEET			
Commitments to fund loans	--	--	
Standby letters of credit	--	--	

The fair value estimates presented herein are based upon pertinent information available to management as of December 31, 2000 and 1999. The fair value amounts have not been comprehensively reevaluated since the reporting date. Therefore, current estimates of fair value and the amounts realizable in current secondary market transactions may differ significantly from the amounts presented herein.

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25. QUARTERLY RESULTS OF OPERATIONS (UNAUDITED)

The following is a summary of quarterly results:

	First Quarter	Second Quarter	Thir Quarte
	(Dollars In Thousands, Except		
Year Ended December 31, 2000:			
Interest and dividend income	$9,050	$ 9,411	$ 9,51
Interest expense	4,557	4,859	5,11
Provision for loan losses	250	775	65
Non-interest income	501	583	63
Non-interest expense	3,337	3,369	3,55
Provision for income taxes	608	437	36
Net income	799	554	46
Shares applicable to Basic earnings per share	3,138,424	3,075,153	3,100,16
Basic earnings per share	$ 0.25	$ 0.18	$ 0.1
Shares applicable to Diluted earnings per share	3,150,825	3,076,403	3,103,79
Diluted earnings per share	$ 0.25	$ 0.18	$0.1
Cash dividends paid per share	$ 0.08	$ 0.00	$ 0.0

	First Quarter	Second Quarter	Thir Quarte
	(Dollars In Thousands, Except		
Year Ended December 31, 1999:			
Interest and dividend income	$8,225	$ 8,173	$ 8,57
Interest expense	4,451	4,268	4,21
Provision for loan losses	220	200	26
Non-interest income	684	778	56
Non-interest expense	2,822	2,890	2,97
Provision for income taxes	612	691	73
Net income	804	902	95
Shares applicable to Basic earnings per share	3,213,941	3,235,190	3,256,41
Basic earnings per share	$ 0.25	$ 0.28	$ 0.2
Shares applicable to Diluted earnings per share	3,308,823	3,323,205	3,359,12
Diluted earnings per share	$ 0.24	$ 0.27	$0.2
Cash dividends paid per share	$ 0.07	$ 0.00	$ 0.0

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Item 9. Changes In And Disagreements With Accountants On Accounting And Financial Disclosure

None.

PART III

Item 10. Directors And Executive Officers Of The Registrant

The information relating to Directors and Executive Officers of the Registrant is incorporated herein by reference to the Registrant's Proxy Statement for the Annual Meeting of Stockholders to be held on May 24, 2001, which will be filed no later than 120 days following Registrant's fiscal year end. Information concerning Executive Officers who are not Directors is also contained in Part I of this report pursuant to paragraph (b) of Item 401 of Regulation S-K in reliance on Instruction G.

Item 11. Executive Compensation

The information relating to Director and Executive Officer compensation is incorporated herein by reference to the Registrant's Proxy Statement for the Annual Meeting of Stockholders to be held on May 24, 2001, excluding the Compensation Committee Report on Executive Compensation and the Stock Performance Graph, which will be filed no later than 120 days following the Registrant's fiscal year end.

Item 12. Security Ownership Of Certain Beneficial Owners And Management.

The information relating to security ownership of certain beneficial owners and management is incorporated herein by reference to the Registrant's Proxy Statement for the Annual Meeting of Stockholders to be held on May 24, 2001, which will be filed no later than 120 days following the Registrant's fiscal year end.

Item 13. Certain Relationships And Related Transactions.

The information relating to certain relationships and related transactions is incorporated herein by reference to the Registrant's Proxy Statement for the Annual Meeting of Stockholders to be held on May 24, 2001, which will be filed no later than 120 days following the Registrant's fiscal year end.

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PART IV

Item 14. Exhibits, Financial Statement Schedules, And Reports On Form 8-K.

(a)(1) Financial Statements

The following consolidated financial statements of the Registrant are filed as a part of this document under Item 8, "Financial Statements and

Supplementary Data."

Consolidated Statements Of Financial Condition At December 31, 2000 And 1999.

Consolidated Statements of Operations For Each Of The Years In The Three Year Period Ended December 31, 2000.

Consolidated Statements Of Changes In Stockholders' Equity For Each Of The Years In The Three Year Period Ended December 31, 2000.

Consolidated Statements Of Cash Flows For Each Of The Years In The Three Year Period Ended December 31, 2000.

Notes To Consolidated Financial Statements.

Independent Auditors' Report.

(a)(2) Financial Statement Schedules

Financial Statement Schedules have been omitted because they are not applicable or the required information is shown in the Consolidated Financial Statements or Notes thereto under Item 8, "Financial Statements and Supplementary Data."

(a)(3) Management Contracts (see Item 14 (c), below)

(b) Reports On Form 8-K Filed During The Last Quarter Of The Registrant's Fiscal Year Ended December 31, 2000

(1) Form 8-K dated October 20, 2000 which includes the announcement of David E. Porter joining Monterey Bay Bank as a Senior Vice President, the appointment of C. Edward Holden to the additional position of President of Monterey Bay Bancorp, Inc. and Monterey Bay Bank, and the resignation of Gary C. Tyack as a Senior Vice President of Monterey Bay Bank.

(2) Form 8-K dated October 31, 2000 which includes the announcement of earnings for the quarter ended September 30, 2000 and changes in the Board of Directors.

(3) Form 8-K dated December 26, 2000 which includes the announcement of the repayment in full of a $4.8 million business term loan that had been maintained on non-accrual status since the fourth quarter of 1999. This Form 8-K also includes the announcement of an additional investment of $2.1 million by Monterey Bay Bancorp, Inc. into its Monterey Bay Bank subsidiary.

(4) Form 8-K dated February 8, 2001 which includes the announcement of earnings for the quarter and full fiscal year ended December 31, 2000, the addition of Susan F. Grill as a Senior Vice President of Monterey Bay Bank, the appointment of Larry A. Daniels as a Director of Monterey Bay Bancorp, Inc. and Monterey Bay Bank, the date for the 2001 annual meeting of

stockholders, and the record date for voting at the 2001 annual meeting of stockholders.

(c) Exhibits Required by Securities and Exchange Commission Regulation S-K

Exhibit Number	
3.1	Certificate Of Incorporation Of Monterey Bay Bancorp, Inc.*
3.3	Bylaws Of Monterey Bay Bancorp, Inc. As Amended And Restated Effective March 22, 2001
4.0	Stock Certificate Of Monterey Bay Bancorp, Inc.*
10.8	Form Of Monterey Bay Bank Of Employee Severance Compensation Plan.*
10.9	Monterey Bay Bank 401(k) Plan.*
10.10	Monterey Bay Bank 1995 Retirement Plan For Executive Officers And Directors.*
10.11	Form Of Monterey Bay Bank Performance Equity Program For Executives.**
10.12	Form Of Monterey Bay Bank Recognition And Retention Plan For Outside Directors.**
10.13	Form Of Monterey Bay Bancorp, Inc. 1995 Incentive Stock Option Plan As Amended And Restated Effective May 25, 2000.***
10.14	Form Of Monterey Bay Bancorp, Inc. 1995 Stock Option Plan For Outside Directors.**
10.17	Form Of Amended Change In Control Agreement Between Monterey Bay Bancorp, Inc., Monterey Bay Bank, And Seven Officers Effective March 22, 2001
21	Subsidiary information is incorporated herein by reference to "Part I - Subsidiaries."
23	Consent Of Deloitte & Touche LLP, Independent Auditors.
27	Financial Data Schedule (in electronic filing only).

* Incorporated herein by reference from the Exhibits to the Registration Statement on Form S-1, as amended, filed on September 21, 1994, Registration No. 33-84272.

** Incorporated herein by reference from the Proxy Statement for the Annual Meeting of Stockholders' filed on July 26, 1995.

*** Incorporated herein by reference from the Proxy Statement for the Annual Meeting of Stockholders' filed on April 14, 2000.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

MONTEREY BAY BANCORP, INC.

Date: March 22, 2001 By: /s/ C. Edward Holden

C. Edward Holden
Vice Chairman, Director, Chief Executive Officer, President

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

Name	Title
/s/ McKenzie Moss McKenzie Moss	Chairman of the Board of Directors
/s/ Eugene R. Friend Eugene R. Friend	Vice Chairman, Director
/s/ C. Edward Holden C. Edward Holden	Vice Chairman, Director, Chief Executive Officer, President
/s/ Mark R. Andino Mark R. Andino	Chief Financial Officer (Principal Financial and Accounting Officer)
/s/ Josiah T. Austin Josiah T. Austin	Director
/s/ P. W. Bachan P. W. Bachan	Director
/s/ Edward K. Banks Edward K. Banks	Director
/s/ Nicholas C. Biase Nicholas C. Biase	Director
/s/ Diane S. Bordoni Diane S. Bordoni	Director
/s/ Larry A. Daniels Larry A. Daniels	Director
/s/ Steven Franich	Director

----------------------------------- Steven Franich	
/s/ Stephen G. Hoffmann ----------------------------------- Stephen G. Hoffmann	Director
/s/ Gary L. Manfre ----------------------------------- Gary L. Manfre	Director

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