SUMMIT
STATE BANK

February 17, 2009

Special Inspector General – TARP
1500 Pennsylvania Avenue, NW
Suite 1064
Washington, D.C. 20220

Dear Sir or Madam:

This is in response to your letter dated February 6, 2009, requesting information regarding funds received by Summit State Bank under the TARP and CPP program.

Summit State Bank's anticipated use for the Preferred Capital funds is to support growth of the bank through its lending to the local communities that it serves. The bank has approximately $360 million in assets at December 31, 2008. Its primary area of lending focus is to small businesses, but also makes loans for financing commercial real estate and home loans.

The TARP funds were received under the Capital Purchase Program (CPP) and as such was recorded in separate capital accounts for the preferred stock and warrant on the financial statements (see the year end financial results press release accompaning this letter).

During December, the month in which Summit State Bank received the funds, the bank had a record of new loans generated, $23.5 million, including $9.2 million financing of an alzhiemer facility. Additonally the bank renewed or modified $17.9 million in existing loans during December. These loans would have been made regardless of the new capital, as Summit State Bank was well capiitalized and with very low nonperforming level of assets, however the additional capital enhances our ability to lend at these times and to continue lending as the economy unfolds during the next year.

Executive compensation at Summit State Bank is well below the amounts discussed in Washington or limitations set by the CPP agreements. Management and the Board is cognizant of the compensation limitations. Financial performance, including loan risk classifications are part of several factors considered by The Board of Dircectors in considering executive officer bonuses at year end. As required by the CPP agrements, the five highest paid officers have signed compensation agreements.

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Accompaning this letter is our press release of year end earnings and an article that appeared in the Press Democrat, the local newspaper, which discusses our use of the TARP funds.

Sincerely,

Thomas M. Duryea
President and Chief Executive Officer

Exchange, Summit banks say they're making loans, shoring up reserves

By MICHAEL COIT
THE PRESS DEMOCRAT

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As bank CEOs faced withering criticism in Congress over their use of taxpayer money, Sonoma County bankers Wednesday outlined initial plans to push the stimulus funds back into the local economy by making more loans.

Related Links:

- Sonoma Valley Bank shareholders OK stimulus funding

The Treasury Department has injected nearly $200 billion to shore up the nation's financial system, including more than $50 million combined for Exchange Bank and Summit State Bank.

The two Santa Rosa banks already have made a pair of large loans backed by the federal funds. Bank officials said they will focus the remaining money in a few areas: commercial loans to small businesses and agricultural companies, and, home equity loans to homeowners who still have equity in their properties to tap.

They also plan to hold onto some of the federal funds, enabling them to boost reserves and absorb bad loans as the recession takes a toll on businesses and homeowners.

"We can't generate business activity, but we're in position to support it. These funds are going to go right back into the community," said William Schrader, Exchange Bank president.

The Treasury Department is purchasing stock in local banks to boost lending and help ease tight credit markets. Only healthy banks qualify, a critical factor, said the Sonoma County bankers, who bristled at the perception that their banks were lining up for a bailout.

"That kind of hurts and is frustrating because if you look at our balance sheet and loan performance, it indicates we did do the right thing," said Tom Duryea, Summit State Bank president.

Exchange Bank qualified for the funds despite suffering its first annual loss last year in at least five decades. The county's oldest and largest local bank has been hit hard by troubled loans made to homebuilders, but still has a strong capital position based on regulatory guidelines.

The Treasury Department effort is part of a $700 billion rescue plan Congress approved last fall to stabilize the nation's financial system. So far, the government has invested $194.2 billion in 317 banks, with stock purchases ranging from $1 million to $25 billion per bank.

Exchange Bank received $43 million and Summit State Bank received $8.5 million, the maximum amounts allowed based on risk associated with total loans and investments by each bank. A third local bank, Sonoma Valley Bank, has been approved for $8.5 million. Shareholders were meeting late Wednesday to decide whether to accept the money.

For every dollar they receive, banks can generally lend $10, under traditional guidelines. As a result, the federal stimulus funds could enable the three banks to make up to $600 million in additional loans.

Exchange Bank initially loaned $14.7 million to the Santa Rosa redevelopment agency for affordable housing projects.

The remaining funds will be committed to agricultural operations, small businesses and households through a program in development, Schrader said.

"We're going to promote to the public the fact that we're looking for creditworthy borrowers," Schrader said. "This gives us an added capital cushion. Without it there would have been more cautiousness."

Exchange Bank reduced lending slightly in the fourth quarter. The bank reported $1.16 billion in outstanding loans at the end of the year, $35 million less than it had three months earlier. The reason: Fewer borrowers applied for loans as the economy slumped, and the bank continued to write off bad loans, Schrader said.

Summit State, on the other hand, increased its lending in the fourth quarter. The bank reported $299 million in outstanding loans at year's end, up $15.2 million from the beginning of the quarter. The bank has been able to increase lending because it hasn't had to boost reserves to cover problem loans.

In December, the bank tallied its largest volume of new loans for a single month, including $9.2 million to the buyers of an Alzheimer's residential care facility in Petaluma, Duryea said.

"We would have been able to make that loan without the federal funds. However, it certainly enhances your ability to lend, especially in the economic environment we're in," Duryea said.

Going forward, the bank will focus on making loans to commercial and industrial borrowers, he said.

"It's the juice that keeps businesses and our communities going," Duryea said.

You can reach Staff Writer Michael Coit at 521-5470 or mike.coit@pressdemocrat.com.

News Release

For Immediate Release

Contact: Dennis E. Kelley, Senior VP and CFO, Summit State Bank (707)568-4910

Summit State Bank Reports 73% Increase in Fourth Quarter Results and Declaration of Dividend

SANTA ROSA, CA – (January 26, 2009) – Summit State Bank (Nasdaq: SSBI) today reported strong, continuing improvements in the bank's net income representing a 73% increase over the same quarter of 2007. "We continue to benefit from measured asset growth with smart community lending, improved net interest margins, greater efficiencies in operations, and excellent asset quality," said President & CEO, Thomas Duryea.

Dividend

On January 26, 2009, the Board of Directors declared a quarterly cash dividend of $0.09 per share on the Company's common Stock. The dividend is payable February 23, 2009 to shareholders of record as of the close of business on February 12, 2009. The Board of Directors also declared a $66,111 quarterly dividend payable on February 15, 2009, on the Fixed Rate Non-Cumulative Perpetual Preferred Stock, Series A, which was issued to the U.S. Department of the Treasury on December 19, 2008.

Net Income and Results of Operation

Net operating income was $764,000 or $0.16 per diluted share for the fourth quarter of 2008, reflecting an improved net interest margin, continuing strength in asset quality, and focus on operating efficiencies. This represented a $323,000 or 73% increase to net income of $441,000 or $0.09 per diluted share for the fourth quarter of 2007.

Before other than temporary impairment charges on investment securities (OTTI), net income was $842,000 in the fourth quarter 2008 representing a $401,000 or 91% increase over fourth quarter 2007.

The fourth quarter benefited from loan growth and further improvement in cost of funding, which increased net interest income to $3,343,000, a 23% increase over the fourth quarter of 2007. The net interest margin increased to 3.95% for the fourth quarter of 2008 compared to 3.36% for the fourth quarter of 2007.

"Loan growth of 12% from December 31, 2007 to December 31, 2008 added to interest earning assets. Moreover, the Bank benefited from continuing aggressive funds management that has reduced our funding costs to 2.71% in the fourth quarter of 2008 from 4.38.% for the same quarter in 2007," said Dennis Kelley, Chief Financial Officer.

The bank's efficiency ratio, excluding OTTI charges, improved to 54% at the fourth quarter of 2008 from 67% at the fourth quarter 2007.

For the year ended December 31, 2008, net income was $1,009,000 or $0.21 per diluted share, a 48% decline from the 2007 annual net income of $1,942,000 or $0.40 per diluted share due largely to other than temporary impairment charges (OTTI) primarily recorded in the third quarter due to the valuations of Fannie Mae and Freddie Mac preferred stocks and other corporate bond investments.

Before charges, including OTTI, employee severance and IT system conversion costs, net income was $2,770,000 in 2008 or 43 % higher than in 2007.

Total shareholders' equity was $55,561,000 at December 31, 2008, which includes the $8,500,000 in preferred stock and common stock warrants issued to the U.S. Department of the Treasury under the governments Capital Purchase Program (CPP). Book value per common share was $9.92 at December 31, 2008. The Bank's regulatory capital remains well above the required capital ratios with a Tier 1 capital leverage ratio of 14.8%; a Tier 1 risk-based capital ratio of 17.4%; and a Total risk-based capital ratio of 18.6% ranking in the top tier of local and national banks.

Nonperforming loans at December 31, 2008 were $1,046,000, of which $461,000 is guaranteed by the Small Business Administration and all are secured by real estate at conforming advances. The nonperforming assets to total assets ratio was 0.29% at December 31, 2008 and 0.23% after SBA guaranty. The bank's performing loan portfolio ranks favorably compared to peer banks. The Bank had one investment bond with a book value of $17,000 that had payments deferred.

The Bank had 0% of its loans past due 30 to 89 days for the sixth quarter out of the past seven, including all of 2008.

The bank had no REO (foreclosed properties) during 2008.

The provision for loan losses was $220,000 for the fourth quarter ended December 31, 2008 as compared to $259,000 in the fourth quarter of 2007 and $685,000 for the full year 2008 compared to $749,000 in 2007. The Bank had $142,000 in loan charge-offs and $57,000 in loan recoveries during the fourth quarter of 2008. At December 31, 2008, the allowance for loan losses was $4,016,000 and represented a ratio to gross loans of 1.32% and to nonperforming loans of 384%. These ratios compare to 1.34% and 779% at December 31, 2007.

Average earning assets were $336,161,000 for the fourth quarter of 2008, as compared to $321,172,000 for the same quarter of 2007. The annualized yield on average earning assets was 6.30% and the annualized cost of average interest-bearing liabilities was 2.71% for the fourth quarter of 2008, as compared to the annualized yield on average earning assets of 7.16% and annualized cost of interest-bearing liabilities of 4.38% for the same quarter of 2007. Total loans increased $15,365,000 during the fourth quarter of 2008, representing an annualized growth rate of 21% from the third quarter of 2008.

For the fourth quarter of 2008, non-interest expense decreased $44,000 or 2% to $1,972,000, compared to the same quarter in 2007. Non-interest expense increased to $8,639,000 for the year ended December 31, 2008 compared to $7,993,000, with the increase primarily attributable to the costs associated with conversion to a new data processor, employee severance expenses; and full year costs of a branch opened in July 2007.

The Bank recorded a non cash OTTI charge on Investments in the fourth quarter of $134,000 and for the year $2,457,000. The OTTI charge in the fourth quarter was the further write down of government agency preferred stocks and one trust preferred pooled security. The remaining recorded book value of these securities at December 31, 2008 was $46,000. In the third quarter the Bank recorded an OTTI charge on a GMAC bond with a par value of $500,000 and current book value of $263,000. The market value of the GMAC bond recovered to $375,000 at December 31, 2008.

Total assets were $364,333,000 at December 31, 2008, an increase of $24,140,000, or 7%, compared to $340,193,000 at December 31, 2007.

"We are pleased with the results of the fourth quarter and our operating earnings growth in 2008. We remain committed to driving stronger results in 2009 and beyond. We are on an upward trend in operating results and are entering 2009 with a net interest margin of 4%. The excellent asset quality ratios at year end are testament to our prudent underwriting standards employed by our strong, experienced credit team. With our strong capital position, we look forward to continuing to serve the banking needs of our community, so essential in these times." said Thomas Duryea, President & CEO.

About Summit State Bank

Summit State Bank has total assets of $364 million and total equity of $56 million at December 31, 2008. Headquartered in Sonoma County, the Bank provides diverse financial products and services throughout Sonoma, Napa, San Francisco, and Marin Counties. Summit State Bank stock is traded on the Nasdaq Global Market under the symbol SSBI. Further information can be found at www.summitstatebank.com.

Forward-looking Statements

Except for historical information contained herein, the statements contained in this news release, are forward-looking statements within the meaning of the "safe harbor" provisions of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. This release may contain forward-looking statements that are subject to risks and uncertainties. Such risks and uncertainties may include but are not necessarily limited to fluctuations in interest rates, inflation, government regulations and general economic conditions, and competition within the business areas in which the Bank will be conducting its operations, including the real estate market in California and other factors beyond the Bank's control. Such risks and uncertainties could cause results for subsequent interim periods or for the entire year to differ materially from those indicated. You should not place undue reliance on the forward-looking statements, which reflect management's view only as of the date hereof. The Bank undertakes no obligation to publicly revise these forward-looking statements to reflect subsequent events or circumstances.

SUMMIT STATE BANK AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except for earnings per share data)

	Three Months Ended		Twelve Months Ended	
	December 31, 2008 (Unaudited)	December 31, 2007	December 31, 2008 (Unaudited)	December, 31 2007
Interest income:				
Interest and fees on loans	$ 4,726	$ 5,166	$ 18,848	$ 20,327
Interest on Federal funds sold	-	3	69	6
Interest on investment securities and deposits in banks	602	581	2,523	2,293
Dividends on FHLB stock	7	43	114	129
Total interest income	5,335	5,793	21,554	22,755
Interest expense:				
Deposits	1,663	2,485	7,332	9,869
Securities sold under repurchase agreements	-	-	-	2
FHLB advances	329	587	1,879	2,033
Total interest expense	1,992	3,072	9,211	11,904
Net interest income before provision for loan losses	3,343	2,721	12,343	10,851
Provision for loan losses	220	259	685	749
Net interest income after provision for loan losses	3,123	2,462	11,658	10,102
Non-interest income:				
Service charges	94	96	404	352
Office leases	181	183	669	699
Gains on sales of loans	-	-	-	41
Securities Impairment	(134)	-	(2,457)	-
Loan servicing, net	2	15	46	65
Other income	13	5	35	39
Total non-interest income	156	299	(1,303)	1,196
Non-interest expense:				
Salaries and employee benefits	946	1,061	4,343	3,974
Occupancy and equipment	443	436	1,735	1,624
Other expenses	583	519	2,561	2,395
Total non-interest expense	1,972	2,016	8,639	7,993
Income before provision for income taxes	1,307	745	1,716	3,305
Provision for Income taxes	543	304	707	1,363
Net income	$ 764	$ 441	$ 1,009	$ 1,942
Less: Accretion of perferred stock discount	(4)	-	(4)	-
Net Income available for common stock	$ 760	$ 441	$ 1,005	$ 1,942
Basic earnings per share	$ 0.16	$ 0.09	$ 0.21	$ 0.40
Diluted earnings per share	$ 0.16	$ 0.09	$ 0.21	$ 0.40
Basic weighted average shares of common stock outstanding	4,745	4,805	4,745	4,831
Diluted weighted average shares of common stock outstanding	4,745	4,808	4,745	4,834

SUMMIT STATE BANK AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
(In thousands)

	December 31, 2008 (Unaudited)	December 31, 2007
ASSETS		
Cash and due from banks	$ 3,650	$ 5,695
Federal funds sold	-	7,110
Total cash and cash equivalents	3,650	12,805
Time deposits in banks	-	80
Available-for-sale investment securities - amortized cost of $41,089 in 2008 and $35,404 in 2007	41,183	35,426
Held-to-maturity investment securities - market value of $5,000 in 2007	-	5,000
Loans, less allowance for loan losses of $4,016 in 2008 and $3,621 in 2007	299,645	267,067
Bank premises and equipment, net	7,816	8,463
Investment in Federal Home Loan Bank stock, at cost	2,695	2,850
Goodwill	4,119	4,119
Accrued interest receivable and other assets	5,225	4,383
Total assets	$ 364,333	$ 340,193
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Demand - non interest-bearing	$ 10,773	$ 10,297
Demand - interest-bearing	13,597	12,421
Savings	10,068	12,460
Money market	26,123	29,858
Time deposits, $100,000 and over	84,751	103,995
Other time deposits	107,451	79,988
Total deposits	252,763	249,019
Federal Home Loan Bank (FHLB) advances	55,173	42,600
Accrued interest payable and other liabilities	836	859
Total liabilities	308,772	292,478
Shareholders' equity		
Preferred stock (net); 20,000 shares authorized; 8,500 issued at December 31, 2008	7,882	-
Common stock, no par value; shares authorized - 30,000;		
shares isssued and outstanding - 4,745 at December 31, 2008 and 2007	36,251	36,244
Common stock warrants	622	-
Retained earnings	10,752	11,455
Accumulated other comprehensive income (loss), net of taxes	54	16
Total shareholders' equity	55,561	47,715
Total liabilities and shareholders' equity	$ 364,333	$ 340,193

(In Thousands Except Per share Data)

	Three Months Ended		Twelve Months Ended	
	December 31, 2008	**December 31, 2007**	**December 31, 2008**	**December 31, 2007**
	(Unaudited)	**(Unaudited)**	**(Unaudited)**	**(Unaudited)**
Statement of Income Data:				
Net interest income	$ 3,343	$ 2,721	$ 12,343	$ 10,851
Provision for loan losses	220	259	685	749
Total non-interest income	156	299	(1,303)	1,196
Total non-interest expense	1,972	2,016	8,639	7,993
Provision for Income taxes	543	304	707	1,363
Net income	$ 764	$ 441	$ 1,009	$ 1,942
Selected per Share Data:				
Earnings per share - basic	$ 0.16	$ 0.09	$ 0.21	$ 0.40
Earnings per share - diluted	$ 0.16	$ 0.09	$ 0.21	$ 0.40
Book value per share (2)	$ 10.05	$ 10.06	$ 10.05	$ 10.06
Nonperformaing assets:				
Loans on non-accrual or past due more than 90 days	$ 1,046	$ 465	$ 1,046	$ 465
Other nonperforming assets	$ 17	$ -	$ 17	$ -
Selected Ratios:				
Return on average assets (1)	0.86%	0.52%	0.29%	0.59%
Return on average equity (1)	6.36%	3.61%	2.12%	4.03%
Return on average tangible equity (1)	6.96%	3.94%	2.32%	4.40%
Net interest margin (1)	3.95%	3.36%	3.78%	3.49%
Dividend payout ratio	56.18%	98.64%	56.18%	89.75%
Average equity to average assets	13.55%	14.28%	13.88%	14.64%
Leveraged capital ratio	14.76%	12.48%	14.76%	12.98%
Efficiency ratio (3)	54.28%	66.75%	64.01%	66.35%
Nonperforming loans to total loans (2)	0.34%	0.17%	0.34%	0.17%
Nonperforming assets to total assets (2)	0.29%	0.14%	0.29%	0.14%
Allowance for loan losses to total loans (2)	1.32%	1.34%	1.32%	1.34%
Allowance for loan losses to nonperforming loans (2)	384%	779%	384%	779%

(1) Annualized.
(2) As of period end

(3) Efficiency ratio is noninterest expenses divided by net interest income and noninterest income, excluding other than temporary impairment charges.