Heritage Oaks Bancorp

Expect More

2006
Annual Report

March 2007

Shareholders of Heritage Oaks Bancorp,

It is with mixed emotions that I write this last letter to you the Shareholders of Heritage Oaks Bancorp: I am sad to be leaving an organization that has been so much a part of my life for the last twenty-five years, but confident about the future of the organization.

Twenty-five years ago, the bank was just a dream of five men, none of whom were bankers, and with no money pledged for capital. At December 31, 2006, the Bank and Bancorp have 12 branches, 212 employees, approximately 1,815 Shareholders and an approximate market value of $109 million. The listing of our stock on NASDAQ has given our stock a liquidity that many community banks do not enjoy.

All the elements are in place to continue the growth and profitability of the corporation. The Board of Directors is composed of some of the finest people I have had the privilege to know. The management team has proven themselves over the last fifteen to twenty years to be great bankers. Our staff is one that we can all look to with pride. Our customers and shareholders have shown themselves to be loyal and dedicated to the success of the corporation.

As has already been announced, I shall recommend to the Nominating and Governance Committee that Michael J. Morris be the next Chairman of the Board. Mike, who is Chairman of the Board of the law firm of Andre, Morris and Buttery, is well known, respected in the community, and has a sterling reputation of success in all the endeavors he has pursued.

While the future cannot be predicted, the personnel and policies are in place to allow your corporation to continue to grow and thrive.

Thank you for a wonderful, rewarding twenty-five years.

Dr. B.R. Bryant

Dr. B.R. Bryant
Chairman of the Board

March 2007

Shareholders of Heritage Oaks Bancorp,

2006 was an unusual year in many respects. Throughout the entire year, we worked on re-branding our company setting in place the foundation for our future. It was also a year we saw continued strong loan demand and for the first time in many years, reported level profits compared to the prior year. Rising short term interest rates, a narrowing net interest margin, a flat to inverted yield curve and increased non interest expenses all impacted profit growth in 2006.

We all know that what goes down must come up, and that what goes up must come down. Well, we saw interest rates for both short term as well as long term going down throughout 2002 and 2003, holding relatively flat at the bottom during the first half of 2004. In the middle of 2004 we really started to see things change. Short-term interest rates began to move up very quickly, holding to that pattern for the next 18 months, throughout all of 2005. This rise in short-term interest rates was somewhat unusual, however, in that it was not accompanied by a move up in long-term interest rates. The result was that in the beginning of 2006, long-term interest rates were even with short term interest rates, resulting in a flat yield curve. During the first half of 2006, short-term interest rates moved up another 50 basis points and by midyear 2006, we were looking at an inverted yield curve.

The inverted yield curve was the primary driver in the cost of deposits and other borrowings being sharply higher in 2006, relative to the previous year. All the while deposit costs were rising; yields on loans were little changed. As the cost of deposits increased, and the availability of low cost demand deposits slowed dramatically, we looked to fund our loan demand through FHLB borrowings resulting in contraction of our net interest margin. Costs associated with FHLB borrowings increased by over 300 basis points from 2005 and was a major contributor in bringing down our margin in the fourth quarter of 2006.

The inverted yield curve also impacted the housing sector, slowing the rate of home appreciation, and in some areas we even saw home prices drop. Home purchases slowed by over 50% during the year and home refinances slowed even further. People finally stopped looking at the equity in their homes as excess spending money as they had been over the previous 5 years, and the results were felt throughout the economy.

What does all of this mean to the shareholders of HEOP? When you review the financial information provided in this year's annual report, you will see that the loan portfolio enjoyed significant growth in 2006. Demand for loans remained strong allowing us to increase the level of earning assets by over 21%. At the same time, you will also note that the yield on earning assets remained relatively flat when compared to prior years as our ability to price loans based on Prime was negatively impacted, as long term interest rates are now lower than short-term interest rates. On the expense side of the ledger you will see that our interest expense more than doubled as the lag in deposit re-pricing experienced in 2005 caught up with us in 2006. As I stated above, we increased our borrowings from the FHLB in 2006 as a method of funding our loan growth. These borrowings carried an interest rate well above our average cost of deposits and had a negative effect on our net interest margin in the fourth quarter.

As you review the financial statements attached you will also note that our expense for salaries and employee benefits increased significantly during 2006. There was a two-fold reason for this increase: first, we spent the better part of the year performing research to determine how we could improve the delivery of our products and services to our clients, as well as how we could increase our market share, through re-branding of our company. To continue to grow successfully the quality of talent within our organization needed to do the same. This led to some key hires as well as major reorganizations of several departments. The infrastructure is now in place to enable us to take advantage of the myriad market opportunities we now have in front of us.

On a final note, I would like to congratulate Dr. Bryant on his twenty-five years of service to Heritage Oaks Bank and Heritage Oaks Bancorp. His leadership and dedication to this company has been second to none and I can only say we will miss him as much as he will miss us.

Lawrence P. Ward

Lawrence P. Ward
President & CEO

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-K

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 for the Year ended December 31, 2006

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 For the transition period from _____ to

Commission file number 0-25020

Heritage Oaks Bancorp
(Exact name of registrant as specified in its charter)

State of California (State or other jurisdiction of employee incorporation or organization)	77-0388249 (I.R.S. Identification No.)
545 12th Street, Paso Robles, California 93446 (Address of principal executive offices) (Zip Code)	(805) 239-5200 (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:

Title of each class	Name of each exchange on which registered
Common Stock, (no par value)	NASDAQ Capital Market

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

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

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

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 [ ].

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or is a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act (check one.)
Large Accelerated filer [ ] Accelerated filer [X] Non-accelerated filer [ ].

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the Registrant at June 30, 2006 was $76.5 million. As of February 1, 2007, the Registrant had 6,377,997 shares of Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

The information required in Part III, Items 10 through 14 are incorporated by reference to the registrant's definitive proxy statement for the 2007 annual meeting of shareholders.

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PART I

Certain statements contained in this Annual Report on Form 10-K (“Annual Report”), including, without limitation, statements containing the words “believes”, “anticipates”, “intends”, “expects”, and words of similar impact, constitute “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities and Exchange Act of 1934. Such forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause the actual results, performance or achievements of the Company to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Such factors include, among others, the following: general economic and business conditions in those areas in which the Company operates, demographic changes, competition, fluctuations in interest rates, changes in business strategy or development plans, changes in governmental regulation, credit quality, the availability of capital to fund the expansion of the Company’s business, economic, political and global changes arising from the war on terrorism and other factors referenced in this report, including in “Item 1A. Risk Factors.” The Company disclaims any obligation to update any such factors or to publicly announce the results of any revisions to any of the forward-looking statements contained herein to reflect future events or developments.

ITEM 1. DESCRIPTION OF BUSINESS.

General

Heritage Oaks Bancorp (the "Company", “we” or “our”) is a California corporation organized in 1994 to act as the holding company of Heritage Oaks Bank (the “Bank"). In 1994, the Company acquired all of the outstanding common stock of the Bank in a holding company formation transaction.

In April 2002, the Company formed Heritage Oaks Capital Trust I (the “Trust I”). The Trust I is a statutory business trust formed under the laws of the State of Delaware. The Trust I is a wholly-owned, non-financial, non-consolidated subsidiary of the Company.

In October 2006, the Company formed Heritage Oaks Capital Trust II (the “Trust II”). The Trust II is a statutory business trust formed under the laws of the State of Delaware. The Trust II is a wholly-owned, non-financial, non-consolidated subsidiary of the Company.

Other than holding the shares of the Bank, the Company conducts no significant activities, although it is authorized, with the prior approval of the Board of Governors of the Federal Reserve System (the "Federal Reserve Board"), the Company's principal regulator, to engage in a variety of activities which are deemed closely related to the business of banking. The Company has also incorporated a subsidiary, CCMS Systems, Inc. which is currently inactive and has not been capitalized. The Company has no present plans to activate the proposed subsidiary, nor to engage in such other permitted activities.

Banking Services

The Bank was licensed by the California Department of Financial Institutions (“DFI”) and commenced operation in January 1983. As a California state bank, the Bank is subject to primary supervision, examination and regulation by the DFI and the Federal Deposit Insurance Corporation (“FDIC”). The Bank is also subject to certain other federal laws and regulations. The deposits of the Bank are insured by the FDIC up to the applicable limits thereof.

At December 31, 2006, the Company had approximately $542 million in consolidated assets, $439 million in net consolidated loans, $421 million in consolidated deposits, and $49 million in stockholders' equity.

The Bank is headquartered in Paso Robles, California with one branch office in Paso Robles, two branches in San Luis Obispo, one branch office in Cambria, one branch office in Arroyo Grande, three branch offices in Santa Maria, one branch office in Atascadero, one branch office in Morro Bay, and one branch office in Templeton. The Bank conducts a commercial banking business in San Luis Obispo County and Northern Santa Barbara County, including accepting demand, savings and time deposits, and making commercial, real estate, SBA, agricultural, credit card, and consumer loans. The Bank also offers installment note collection, issues cashier's checks and money orders, sells travelers checks, and provides bank-by-mail, night depository, safe deposit boxes, and other customary banking services. The Bank does not offer trust services or international banking services and does not plan to do so in the near future.

The Bank's operating policies since inception have emphasized small business, commercial and retail banking. Most of the Bank's customers are retail customers, farmers and small to medium-sized businesses. The Bank takes real estate, listed and unlisted securities, savings and time deposits, automobiles, machinery and equipment as collateral for loans. The areas in which the Bank has directed virtually all of its lending activities are (i) commercial and agricultural loans, (ii) installment loans, (iii) construction loans, and (iv) other real estate loans or commercial loans secured by real estate. As of December 31, 2006, these four categories accounted for approximately 19.1%, 1.3%, 23.8% and 55.8% respectively, of the Bank's loan portfolio. As of December 31, 2006, $353.9 million or 79.5% of the Bank's $445 million in gross loans consisted of interim construction and other real estate secured loans, primarily for single family residences or for commercial development. Commercial and agricultural loans increased $24.9 million or 41.5% and other real estate loans or commercial loans secured by real estate increased $23.1 million or 10.3% between year-end 2005 and year-end 2006. See "Item 7. – Management's Discussion and Analysis of Financial Condition and Results of Operations."

Most of the Bank's deposits are attracted by local promotional activities and advertising in the local media. A material portion of the Bank's deposits have not been obtained from a single person or a few persons, the loss of any one or more of which would have a materially adverse effect on the business of the Bank. Management considers three account relationships with customers engaged in mortgage related businesses to be volatile deposit relationships. These deposit accounts, which are closely monitored by bank management, had combined balances of $44.1 million or 10.5% of total deposits at December 31, 2006 compared to $52.2 million or 12.5% of total deposits at December 31, 2005. Management and the Board of Directors of the Bank are aware that changes in mortgage market conditions have impacted these relationships during 2006. As of December 31, 2006, the Bank had approximately 23,891 deposit accounts consisting of non-interest bearing ("demand"), interest-bearing demand and money market accounts with balances totaling $275.7 million for an average balance per account of approximately $11.5 thousand; 9,608 savings accounts with balances totaling $23.4 million for an average balance per account of approximately $2.4 thousand; and 3,127 time certificate of deposit accounts with balances totaling $121.4 million, for an average balance per account of approximately $38.8 thousand.

The principal sources of the Company's consolidated revenues are (i) interest and fees on loans, (ii) interest on investments, (iii) service charges on deposit accounts and other charges and fees, (iv) mortgage origination fees and (v) miscellaneous income. For the year ended December 31, 2006, these sources comprised 82.0%, 6.0%, 5.9%, 1.3% and 4.8%, respectively, of the Company's total operating income.

The Company has not engaged in any material research activities relating to the development of new services or the improvement of existing bank services, except as otherwise discussed herein. There has been no significant change in the types of services offered by the Bank since its inception. The Company has no present plans regarding "a new line of business" requiring the investment of a material amount of total assets. Most of the Company's business originates from San Luis Obispo and Northern Santa Barbara Counties and there is no emphasis on foreign sources and application of funds. The Company's business, based upon performance to date, does not appear to be seasonal. Management of the Company is unaware of any material effect upon the Company's capital expenditures, earnings or competitive position as a result of federal, state or local environmental regulations.

The Bank holds service marks issued by the U.S. Patent and Trademark Office for the "Acorn" design, the "Oakley" design and "Deeply Rooted in Your Hometown."

Employees

As of December 31, 2006, the Bank had 212 full-time equivalent employees. The Company has only two salaried employees. The Bank believes that its employee relations are positive.

Local Economic Climate

The economy in the Company's service area is based primarily on agriculture, tourism, light industry, oil and retail trade. Services supporting these industries have also developed in the areas of medical, financial and educational services. The population of San Luis Obispo County and the City of Santa Maria (in Northern Santa Barbara County) totaled approximately 260,000 and 92,000, respectively, according to economic data provided by local county and title company sources. The moderate climate allows a year round growing season for numerous vegetable and fruits. Vineyards and cattle ranches also contribute largely to the local economy. The Central Coast's leading agricultural industry is the production of high quality wine grapes and production of premium quality wines. Although on average the climate in our markets is generally very mild, we did experience a significant freeze in early 2007. This did not have a significant impact on our business. Vineyards in production have grown significantly over the past several years throughout the Company's service area. Access to numerous recreational activities, including lakes, mountains and beaches, provide a relatively stable tourist industry from many areas including the Los Angeles/Orange County basin, the San Francisco Bay area and the San Joaquin Valley. Principally due to the diversity of the various industries in the Company's service area, the area, while not immune from economic fluctuations, does tend to enjoy a more stable level of economic activity than many other areas of California.

Throughout the primary market area of the Company, the softening housing market of 2006 is expected to continue into 2007, though it is unknown just how long-lasting the slowdown might be. The number of homes sold in 2006 was 25% less than 2005, according to real estate research firm DataQuick.

Some economists predict housing prices will rise again next year based on the nontraditional nature of the market that includes buyers bringing in equity earned in other parts of the state. An economic forecast created for the county by University of California at Santa Barbara projects the median home price for 2007 to be up 2% from that in 2006. The 2008 median price is expected to rise by 5%.

Competition

Banking and the financial services business in California generally, and in the Company's service area specifically, is highly competitive. The increasingly competitive environment is a result primarily of changes in regulation, changes in technology and product delivery systems, and the accelerating pace of consolidation among financial services providers and the appearance of new banking organizations. The flattening and inverted yield curve environment during the past two years further drove competition as borrowers have expanded choices of maturities within attractive ranges of offered interest rates resulting in various borrower strategies based upon interest rate expectations including choosing longer term fixed rate loans over variable Prime-based loans.

In order to compete with other financial institutions in its service area, the Bank relies principally upon local advertising programs; direct personal contact by officers, directors, employees, and shareholders; and specialized services such as courier pick-up and delivery of non-cash banking items. The Bank emphasizes to customers the advantages of dealing with a locally owned and community oriented institution. The Bank also seeks to provide special services and programs for individuals in its primary service area who are employed in the agricultural, professional and business fields, such as loans for equipment, furniture, tools of the trade or expansion of practices or businesses. Larger banks may have a competitive advantage because of higher lending limits and major advertising and marketing campaigns. They also perform services, such as trust services, international banking, discount brokerage and insurance services that the Bank is not authorized or prepared to offer currently. The Bank has made arrangements with correspondent banks and with others to provide such services for its customers. For borrowers requiring loans in excess of the Bank's legal lending limits, the Bank has offered, and intends to offer in the future, such loans on a participating basis with correspondent banks and with other independent banks, retaining the portion of such loans which is within its lending limit. As of December 31, 2006, the Bank's legal lending limits to a single borrower and such borrower's related parties was approximately $9.3 million on an unsecured basis and approximately $15.5 million on a fully secured basis. These calculations are based on regulatory capital plus reserves of $62.1 million for the Bank.

Commercial banks compete with savings and loan associations, credit unions, other financial institutions, securities brokerage firms, and other entities for funds. For instance, yields on corporate and government debt securities and other commercial paper affect the ability of commercial banks to attract and hold deposits. Commercial banks also compete for loans with savings and loan associations, credit unions, consumer finance companies, mortgage companies and other lending institutions.

The financial services industry is undergoing rapid technological changes involving frequent introductions of new technology-driven products and services that have further increased competition. There can also be no assurance that these technological improvements, if made, will increase the Company's operational efficiency or that the Company will be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to our customers.

Effect of Government Policies and Recent Legislation

Banking is a business that depends on rate differentials. In general, the difference between the interest rate paid by the Company on deposits and other borrowings and the interest rate received by the Company on loans extended to its customers and securities held in the portfolio comprise the major portion of the Company's earnings. These rates are highly sensitive to many factors that are beyond the control of the Company. Accordingly, the earnings and growth of the Company are subject to the influence of domestic and foreign economic conditions, including inflation, recession and unemployment.

The commercial banking business is not only affected by general economic conditions but is also influenced by the monetary and fiscal policies of the federal government and the policies of regulatory agencies, particularly the Federal Reserve Board. The Federal Reserve Board implements national monetary policies (with objectives such as curbing inflation and combating recession) by its open-market operations in United States Government securities, by adjusting the required level of reserves for financial institutions subject to its reserve requirements and by varying the discount rates applicable to borrowings by depository institutions. The actions of the Federal Reserve Board in these areas influence the growth of bank loans, investments and deposits and also affect interest rates charged on loans and paid on deposits. The nature and impact on the Company of any future changes in monetary policies cannot be predicted.

From time to time, legislation is enacted which has the effect of increasing the cost of doing business, limiting or expanding permissible activities or affecting the competitive balance between banks and other financial institutions. Proposals to change the laws and regulations governing the operations and taxation of banks, bank holding companies and other financial institutions are frequently made in Congress, in the California legislature and before various bank regulatory and other professional agencies. See "Supervision and Regulation-Financial Services Modernization Legislation and Sarbanes – Oxley Act of 2002".

Supervision and Regulation

General

The Company and the Bank are extensively regulated under both federal and state law. Set forth below is a summary description of certain laws that relate to the regulation of the Company and the Bank. The description does not purport to be complete and is qualified in its entirety by reference to the applicable laws and regulations.

The Company

The Company is a bank holding company within the meaning of the Bank Holding Company Act of 1956, as amended (the "Bank Holding Company Act"), and is registered as such with, and subject to the supervision of, the Federal Reserve Board. The Company is required to file with the Federal Reserve Board quarterly and annual reports and such additional information as the Federal Reserve Board may require pursuant to the Bank Holding Company Act. The Federal Reserve Board may conduct examinations of bank holding companies and their subsidiaries.

The Company is required to obtain the approval of the Federal Reserve Board before it may acquire all or substantially all of the assets of any bank, or ownership or control of the voting shares of any bank if, after giving effect to such acquisition of shares, the Company would own or control more than 5% of the voting shares of such bank. Prior approval of the Federal Reserve Board is also required for the merger or consolidation of the Company and another bank holding company.

The Company is prohibited by the Bank Holding Company Act, except in certain statutorily prescribed instances, from acquiring direct or indirect ownership or control of more than 5% of the outstanding voting shares of any company that is not a bank or bank holding company and from engaging, directly or indirectly, in activities other than those of banking, managing or controlling banks or furnishing services to its subsidiaries. However, the

Company may, subject to the prior approval of the Federal Reserve Board, engage in any, or acquire shares of companies engaged in, activities that are deemed by the Federal Reserve Board to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. See discussion under "Financial Modernization Act" below for additional information.

The Federal Reserve Board may require that the Company terminate an activity or terminate control of or liquidate or divest subsidiaries or affiliates when the Federal Reserve Board determines that the activity or the control or the subsidiary or affiliates constitutes a significant risk to the financial safety, soundness or stability of any of its banking subsidiaries. The Federal Reserve Board also has the authority to regulate provisions of certain bank holding company debt, including authority to impose interest ceilings and reserve requirements on such debt. Under certain circumstances, the Company must file written notice and obtain approval from the Federal Reserve Board prior to purchasing or redeeming its equity securities.

Under the Federal Reserve Board's regulations, a bank holding company is required to serve as a source of financial and managerial strength to its subsidiary banks and may not conduct its operations in an unsafe and unsound manner. In addition, it is the Federal Reserve Board's policy that in serving as a source of strength to its subsidiary banks, a bank holding company should stand ready to use available resources to provide adequate capital funds to its subsidiary banks during periods of financial stress or adversity and should maintain the financial flexibility and capital-raising capacity to obtain additional resources for assisting its subsidiary banks. A bank holding company's failure to meet its obligations to serve as a source of strength to its subsidiary banks will generally be considered by the Federal Reserve Board to be an unsafe and unsound banking practice or a violation of the Federal Reserve Board's regulations or both.

The Company and the Bank are prohibited from engaging in certain tie-in arrangements in connection with any extension of credit, sale or lease of property or furnishing of services. For example, with certain exceptions, neither the Company nor the Bank may condition an extension of credit to a customer on either (1) a requirement that the customer obtain additional services provided by us or (2) an agreement by the customer to refrain from obtaining other services from a competitor.

The Company is subject to the periodic reporting requirements of the Securities Exchange Act of 1934, as amended, and files reports and proxy statements pursuant to such Act with the Securities and Exchange Commission (the “SEC”)

The Bank

The Bank is chartered under the laws of the State of California and its deposits are insured by the FDIC to the extent provided by law. The Bank is subject to the supervision of, and is regularly examined by, the DFI and the FDIC. For the Bank, such supervision and regulation includes comprehensive reviews of all major aspects of the Bank’s business and condition. Various requirements and restrictions under the laws of the United States and the State of California affect the operations of the Bank. Federal and California statutes relate to many aspects of the Bank’s operations, including reserves against deposits, interest rates payable on deposits, loans, investments, mergers and acquisitions, borrowings, dividends and locations of branch offices. Further, the Bank is required to maintain certain levels of capital.

If, as a result of an examination of a bank, the FDIC or the DFI should determine that the financial condition, capital resources, asset quality, earnings prospects, management, liquidity, or other aspects of a bank’s operations are unsatisfactory or that a bank or its respective management is violating or has violated any law or regulation, various remedies are available to these regulatory agencies. Such remedies include the power to enjoin "unsafe or unsound" practices, to require affirmative action to correct any conditions resulting from any violation or practice, to issue an administrative order that can be judicially enforced, to direct an increase in capital, to restrict growth, to assess civil monetary penalties, to remove officers and directors, and ultimately to terminate deposit insurance, which for a California chartered bank would result in a revocation of the bank’s charter.

Capital Standards

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

A banking organization's risk-based capital ratios are obtained by dividing its qualifying capital by its total risk adjusted assets. The regulators measure risk-adjusted assets, which includes off balance sheet items, against both total qualifying capital (the sum of Tier 1 capital and limited amounts of Tier 2 capital) and Tier 1 capital. Tier 1 capital consists primarily of common stock, retained earnings, non-cumulative perpetual preferred stock (cumulative perpetual preferred stock for bank holding companies) and minority interests in certain subsidiaries, less most intangible assets. Tier 2 capital may consist of a limited amount of the allowance for possible loan and lease losses, cumulative preferred stock, long term preferred stock, eligible term subordinated debt and certain other instruments with some characteristics of equity. The inclusion of elements of Tier 2 capital is subject to certain other requirements and limitations of the federal banking agencies. The federal banking agencies require a minimum ratio of qualifying total capital to risk-adjusted assets of 8% and a minimum ratio of Tier 1 capital to risk-adjusted assets of 4%.

In addition to the risk-based guidelines, federal banking regulators require banking organizations to maintain a minimum amount of Tier 1 capital to total assets, referred to as the leverage ratio. For a banking organization rated in the highest of the five categories used by regulators to rate banking organizations, the minimum leverage ratio of Tier 1 capital to total assets is 3%. For all banking organizations not rated in the highest category, the minimum leverage ratio must be at least 4%. In addition to these uniform risk-based capital guidelines and leverage ratios that apply across the industry, the regulators have the discretion to set individual minimum capital requirements for specific institutions at rates significantly above the minimum guidelines and ratios. Future changes in regulations or practices could further reduce the amount of capital recognized for purposes of capital adequacy. Such a change could affect the ability of the Company to grow and could restrict the amount of profits, if any, available for the payment of dividends.

The following table presents the amount of the capital ratios for the Company and the Bank and the minimum regulatory capital requirements as of December 31, 2006:

	Minimum Regulatory Capital Requirements	Heritage Oaks Bancorp	Heritage Oaks Bank
Leverage Ratio	4.00%	11.00%	9.89%
Tier I Risk Weighted	4.00%	11.51%	10.37%
Total Risk Based	8.00%	12.36%	11.21%

Under applicable regulatory guidelines, the Bank was considered "Well Capitalized" at December 31, 2006.

Under applicable regulatory guidelines, the Company’s trust preferred securities issued by our subsidiary capital trusts qualify as Tier 1 capital up to a maximum limit of 25% of Tier 1 capital. Any additional portion of the trust preferred securities would qualify as Tier II capital. As of December 31, 2006, the subsidiary trusts had $16 million in trust preferred securities outstanding, of which $14.35 million qualify as Tier 1 capital.

In addition, the DFI has authority to take possession of the business and properties of a bank in the event that the tangible shareholders' equity of a Bank is less than the greater of (i) 4% of the banks total assets or (ii) $1,000,000.

Prompt Corrective Action and Other Enforcement Mechanisms

Federal banking agencies possess broad powers to take corrective and other supervisory action to resolve the problems of insured depository institutions, including but not limited to those institutions that fall below one or more prescribed minimum capital ratios described above. An institution that, based upon its capital levels, is classified as well capitalized, adequately capitalized, or undercapitalized may be treated as though it were in the next lower capital category if the appropriate federal banking agency, after notice and opportunity for hearing, determines that an unsafe or unsound condition or an unsafe or unsound practice warrants such treatment. At each successive lower capital category, an insured depository institution is subject to more restrictions. The federal banking agencies, however, may not treat a significantly undercapitalized institution as critically undercapitalized unless its capital ratio actually warrants such treatment.

In addition to measures taken under the prompt corrective action provisions, commercial banking organizations may be subject to potential enforcement actions by the federal regulators for unsafe or unsound practices in conducting their businesses or for violations of any law, rule, regulation, or any condition imposed in writing by the agency or any written agreement with the agency. Enforcement actions may include:

- the imposition of a conservator or receiver or the issuance of a cease-and-desist order that can be judicially enforced;
- the termination of insurance of deposits (in the case of a depository institution);
- the imposition of civil money penalties;
- the issuance of directives to increase capital;
- the issuance of formal and informal agreements;
- the issuance of removal and prohibition orders against institution-affiliated parties; and,
- the enforcement of such actions through injunctions or restraining orders based upon a judicial determination that the agency would be harmed if such equitable relief was not granted.

Additionally, a holding company's inability to serve as a source of strength to its subsidiary banking organizations could serve as an additional basis for a regulatory action against the holding company.

Banks are also subject to certain Federal Reserve Board restrictions on extensions of credit to executive officers, directors, principal shareholders or any related interests of such persons (i.e., insiders). Extensions of credit (1) must be made on substantially the same terms and pursuant to the same credit underwriting procedures as those for comparable transactions with persons who are neither insiders nor employees, and (2) must not involve more than the normal risk of repayment or present other unfavorable features. Banks are also subject to certain lending limits and restrictions on overdrafts to insiders. A violation of these restrictions may result in regulatory sanctions on the bank or its insiders.

Safety and Soundness Standards

The Federal Deposit Insurance Corporation Improvement Act (“FDICIA”) imposes certain specific restrictions on transactions and requires federal banking regulators to adopt overall safety and soundness standards for depository institutions related to internal control, loan underwriting and documentation and asset growth. Among other things, FDICIA limits the interest rates paid on deposits by undercapitalized institutions, restricts the use of brokered deposits, limits the aggregate extensions of credit by a depository institution to an executive officer, director, principal shareholder or related interest, and reduces deposit insurance coverage for deposits offered by undercapitalized institutions for deposits by certain employee benefits accounts. The federal banking agencies may require an institution to submit to an acceptable compliance plan as well as have the flexibility to pursue other more appropriate or effective courses of action given the specific circumstances and severity of an institution's noncompliance with one or more standards.

Premiums for Deposit Insurance

The Bank’s deposits are currently insured to a maximum of $100,000 per depositor ($250,000 for certain retirement accounts) through the Deposit Insurance Fund (“DIF”) administered by the FDIC. The Bank is required to pay deposit insurance premiums, which are assessed semiannually and paid quarterly. In November 2006 the FDIC adopted a new risk-based insurance assessment system effective January 1, 2007 designed to tie what banks pay for deposit insurance more closely to the risks they pose. The FDIC also adopted a new base schedule of rates that the FDIC can adjust up or down, depending on the needs of the DIF, and set initial premiums for 2007 that range from 5 cents per $100 of domestic deposits for banks in the lowest risk category to 43 cents per $100 of domestic deposits for banks in the highest risk category. The new assessment system is not expected to result in a material impact on the Bank.

The FDIC is also empowered to make special assessments on insured depository institutions in amounts determined by the FDIC to be necessary to give it adequate assessment income to repay amounts borrowed from the U.S. Treasury and other sources or for any other purpose the FDIC deems necessary.

The FDIC is authorized to terminate a depository institution's deposit insurance upon a finding by the FDIC that the institution's financial condition is unsafe or unsound or that the institution has engaged in unsafe or unsound practices or has violated any applicable rule, regulation, order or condition enacted or imposed by the institution's regulatory agency.

Sarbanes-Oxley Act of 2002

On July 30, 2002, the Sarbanes-Oxley Act of 2002 (“SOX”), was signed into law to address corporate and accounting fraud. SOX establishes a new accounting oversight board that will enforce auditing standards and restricts the scope of services that accounting firms may provide to their public company audit clients. Among other things, SOX also (i) requires chief executive officers and chief financial officers to certify to the accuracy of periodic reports filed with the SEC; (ii) imposes new disclosure requirements regarding internal controls, off-balance-sheet transactions, and pro forma (non-GAAP) disclosures; (iii) accelerates the time frame for reporting of insider transactions and periodic disclosures by public companies; and (iv) requires companies to disclose whether or not they have adopted a code of ethics for senior financial officers and whether the audit committee includes at least one “audit committee financial expert.”

Under SOX, the SEC is required to regularly and systematically review corporate filings, based on certain enumerated factors. To deter wrongdoing, SOX: (i) subjects bonuses issued to top executives to disgorgement if a restatement of a company’s financial statements was due to corporate misconduct; (ii) prohibits an officer or director from misleading or coercing an auditor; (iii) prohibits insider trades during pension fund “blackout periods”; (iv) imposes new criminal penalties for fraud and other wrongful acts; and (v) extends the period during which certain securities fraud lawsuits can be brought against a company or its officers.

As a public reporting company, the Company is subject to the requirements of SOX and related rules and regulations issued by the SEC and NASDAQ. It is anticipated that the Company will incur additional expense as a result of the Act, but we do not expect that such compliance will have a material impact on our business.

Financial Services Modernization Legislation

On November 12, 1999, the Gramm- Leach-Bliley Act of 1999 (the "Financial Services Modernization Act") was signed into law. The Financial Services Modernization Act is intended to modernize the banking industry by removing barriers to affiliation among banks, insurance companies, the securities industry and other financial service providers. It provides financial organizations with the flexibility of structuring such affiliations through a holding company structure or through a financial subsidiary of a bank, subject to certain limitations. The Financial Services Modernization Act establishes a new type of bank holding company, known as a financial holding company, which may engage in an expanded list of activities that are "financial in nature," which include securities and insurance brokerage, securities underwriting, insurance underwriting and merchant banking. The Company has not sought “financial holding company” status and has no present plans to do so.

The Financial Services Modernization Act also sets forth a system of functional regulation that makes the Federal Reserve Board the "umbrella supervisor" for holding companies, while providing for the supervision of the holding company's subsidiaries by other federal and state agencies.

In addition, the Bank is subject to other provisions of the Financial Services Modernization Act, including those relating to CRA, privacy and safe-guarding confidential customer information, regardless of whether the Company elects to become a financial holding company or to conduct activities through a financial subsidiary of the Bank. The Company does not, however, currently intend to file notice with the Federal Reserve Board to become a financial holding company or to engage in expanded financial activities through a financial subsidiary of the Bank.

The Company and the Bank do not believe that the Financial Services Modernization Act will have a material adverse effect on their operations in the near-term. However, to the extent that it 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. Nevertheless, this act may have the result of increasing the amount of competition that the Company faces from larger institutions and other types of companies offering financial products, many of which may have substantially more financial resources than the Company.

USA Patriot Act of 2001

On October 26, 2001, President Bush signed the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism, or the Patriot Act, of 2001. Among other things, the Patriot Act (i) prohibits banks from providing correspondent accounts directly to foreign shell banks; (ii) imposes due diligence requirements on banks opening or holding accounts for foreign financial institutions or wealthy foreign individuals (iii) requires financial institutions to establish an anti-money-laundering compliance program, and (iv) eliminates civil liability for persons who file suspicious activity reports. The Patriot Act also increases governmental powers to investigate terrorism, including expanded government access to account records and make rules to implement the Patriot Act. On March 9, 2006, the President signed the USA Patriot Improvement and Reauthorization Act, which extended and modified the original act. While we believe the Patriot Act, as amended and reauthorized, may, to some degree, affect our recordkeeping and reporting expenses, we do not believe that it will have a material adverse effect on our business and operations.

Transactions between Affiliates

Transactions between a bank and its "affiliates" are quantitatively and qualitatively restricted under the Federal Reserve Act. The Federal Reserve Board issued Regulation W on October 31, 2002, which comprehensively implements Sections 23A and 23B of the Federal Reserve Act. Sections 23A and 23B and Regulation W restrict loans by a depository institution to its affiliates, asset purchases by a depository institution from its affiliates, and other transactions between a depository institution and its affiliates. Regulation W unifies in one public document the Federal Reserve Board's interpretations of Section 23A and 23B. Regulation W had an effective date of April 1, 2003.

Community Reinvestment Act

The Bank is subject to certain fair lending requirements and reporting obligations involving home mortgage lending operations and Community Reinvestment Act ("CRA") activities. The CRA generally requires the federal banking agencies to evaluate the record of a financial institution in meeting the credit needs of their local communities, including low and moderate income neighborhoods. In addition to substantial penalties and corrective measures that may be required for a violation of certain fair lending laws, the federal banking agencies may take compliance with such laws and CRA into account when regulating and supervising other activities. When a bank holding company applies for approval to acquire a bank or other bank holding company, the Federal Reserve Board will review the assessment of each subsidiary bank of the applicant bank holding company, and such records may be the basis for denying the application. A bank's compliance with its CRA obligations is based on a performance-based evaluation system which bases CRA ratings on an institution's lending service and investment performance, resulting in a rating by the appropriate bank regulatory agency of "outstanding", "satisfactory", "needs to improve" or "substantial noncompliance." At its last examination by the FDIC, the Bank received a CRA rating of "Satisfactory."

Privacy

Federal banking rules limit the ability of banks and other financial institutions to disclose non-public information about consumers to nonaffiliated third parties. Pursuant to these rules, financial institutions must provide:

- initial notices to customers about their privacy policies, describing the conditions under which they may disclose non-public information to nonaffiliated third parties and affiliates;

- annual notices of their privacy policies to current customers; and

- a reasonable method for customers to "opt out" of disclosures to nonaffiliated third parties.

These privacy provisions affect how consumer information is transmitted through diversified financial companies and conveyed to outside vendors. We have implemented our privacy policies in accordance with the law.

In recent years, a number of states have implemented their own versions of privacy laws. For example, in 2003, California adopted standards that are more restrictive than federal law, allowing bank customers the opportunity to bar financial companies from sharing information with their affiliates.

Predatory Lending

The term "predatory lending," much like the terms "safety and soundness" and "unfair and deceptive practices," is far-reaching and covers a potentially broad range of behavior. As such, it does not lend itself to a concise or a comprehensive definition. But typically predatory lending involves at least one, and perhaps all three, of the following elements:

- making unaffordable loans based on the assets of the borrower rather than on the borrower's ability to repay an obligation, or asset-based lending;

- inducing a borrower to refinance a loan repeatedly in order to charge high points and fees each time the loan is refinanced, or loan flipping; and

- engaging in fraud or deception to conceal the true nature of the loan obligation from an unsuspecting or unsophisticated borrower.

Federal Reserve Board regulations aimed at curbing such lending significantly widened the pool of high-cost home-secured loans covered by the Home Ownership and Equity Protection Act of 1994, a federal law that requires extra disclosures and consumer protections to borrowers. The following triggers coverage under the Home Ownership and Equity Protection Act of 1994:

- interest rates for first lien mortgage loans in excess of 8 percentage points above comparable Treasury securities,

- subordinate-lien loans of 10 percentage points above Treasury securities, and

- fees such as optional insurance and similar debt protection costs paid in connection with the credit transaction, when combined with points and fees if deemed excessive.

In addition, the regulation bars loan flipping by the same lender or loan servicer within a year. Lenders also will be presumed to have violated the law—which says loans shouldn't be made to people unable to repay them—unless they document that the borrower has the ability to repay. Lenders that violate the rules face cancellation of loans and penalties equal to the finance charges paid. The Company does not expect these rules and potential state action in this area to have a material impact on our financial condition or results of operations.

Bank Secrecy Act and Money Laundering Control Act

In 1970, Congress passed the Currency and Foreign Transactions Reporting Act, otherwise known as the Bank Secrecy Act (the “BSA”), which established requirements for recordkeeping and reporting by banks and other financial institutions. The BSA was designed to help identify the source, volume and movement of currency and other monetary instruments into and out of the United States in order to help detect and prevent money laundering connected with drug trafficking, terrorism and other criminal activities. The primary tool used to implement BSA requirements is the filing of Suspicious Activity Reports. Today, the BSA requires that all banking institutions develop and provide for the continued administration of a program reasonably designed to assure and monitor compliance with certain recordkeeping and reporting requirements regarding both domestic and international currency transactions. These programs must, at a minimum, provide for a system of internal controls to assure ongoing compliance, provide for independent testing of such systems and compliance, designate individuals responsible for such compliance and provide appropriate personnel training.

Where You Can Find More Information

Under the Securities Exchange Act of 1934 Sections 13 and 15(d), periodic and current reports must be filed with the SEC. The Company electronically files the following reports with the SEC: Form 10-K (Annual Report), Form 10-Q (Quarterly Report), Form 8-K (Current Report), insider ownership reports and Form DEF 14A (Proxy Statement). The Company may file additional forms. The SEC maintains an Internet site, www.sec.gov, in which all forms filed electronically may be accessed. Additionally, all forms filed with the SEC and additional shareholder information is available free of charge on the Company's website: www.heritageoaksbancorp.com
The Company posts these reports to its website as soon as reasonably practicable after filing them with the SEC. None of the information on or hyperlinked from the Company’s website is incorporated into this Annual Report on Form 10-K.

The Company also posts its Committee Charters, Code of Ethics, Code of Conduct and Corporate Governance Guidelines on the Company website.

ITEM 1A. RISK FACTORS

An investment in our common stock is subject to risks inherent to our business. The material risks and uncertainties that management believes may affect our business are described below. Before making an investment decision, you should carefully consider the risks and uncertainties described below together with all of the other information included or incorporated by reference in this Annual Report. The risks and uncertainties described below are not the only ones facing our business. Additional risks and uncertainties that management is not aware of or focused on or that management currently deems immaterial may also impair our business operations. This Annual Report is qualified in its entirety by these risk factors.

If any of the following risks actually occur, our financial condition and results of operations could be materially and adversely affected. If this were to happen, the value of our common stock could decline significantly, and you could lose all or part of your investment.

Risks Associated with our Business.

We are highly dependent on real estate and a downturn in the real estate market could hurt our business.

A significant portion of our loan portfolio is dependent on real estate. At December 31, 2006, real estate served as the principal source of collateral with respect to approximately 79.5% of our loan portfolio. A decline in current economic conditions, a decline in the local housing market, such as the one we are experiencing currently, or rising interest rates could have an adverse effect on the demand for new loans, the ability of borrowers to repay outstanding loans, the value of real estate and other collateral securing loans and the value of real estate owned by us, as well as our financial condition and results of operations in general and the market value of our common stock.

Acts of nature, including earthquakes, floods and fires, which may cause uninsured damage and other loss of value to real estate that secures these loans, may also negatively impact our financial condition.

We also have a concentration in higher risk commercial real estate loans.

We also have a high concentration in commercial real estate or CRE loans. CRE loans as defined by final guidance issued by Bank regulators is defined as construction, land development, other land loans, loans secured by multifamily (5 or more) residential properties, and loans secured by non-farm nonresidential properties. Following this definition, approximately 71.8% of our lending portfolio can be classified as CRE lending. CRE loans generally involve a higher degree of credit risk than residential mortgage lending due, among other things, to the large amounts loaned to individual borrowers. Losses incurred on loans to a small number of borrowers could have a material adverse impact on our income and financial condition. In addition, unlike residential mortgage loans, commercial real estate loans generally depend on the cash flow from the property to service the debt. Cash flow may be significantly affected by general economic conditions.

In addition, federal banking regulators recently issued final guidance regarding commercial real estate lending. This guidance suggests that institutions that are potentially exposed to significant commercial real estate concentration risk will be subject to increased regulatory scrutiny. Institutions that have experienced rapid growth in commercial real estate lending, have notable exposure to a specific type of commercial real estate lending, or are approaching or exceed certain supervisory criteria that measure an institution's commercial real estate portfolio against its capital levels, may be subject to such increased regulatory scrutiny. Our commercial real estate portfolio may be viewed as falling within one or more of the foregoing categories, and accordingly we may become subject to increased regulatory scrutiny because of our commercial real estate portfolio. If it is determined by our regulator that we have an undue concentration in commercial real estate lending, we may be required to maintain increased levels of capital and/or be required to reduce our concentration in commercial real estate loans.

Our real estate lending also exposes us to the risk of environmental liabilities.

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

Our business is subject to interest rate risk and changes in interest rates may adversely affect our performance and financial condition.

Our earnings are impacted by changing interest rates. Changes in interest rates impact the demand for new loans, the credit profile of our borrowers, the rates received on loans and securities and rates paid on deposits and borrowings. The difference between the rates received on loans and securities and the rates paid on deposits and borrowings is known as interest rate spread. Given our current volume and mix of interest-bearing liabilities and interest-earning assets, we would expect our interest rate spread to increase if interest rates rise and, conversely, to decline if interest rates fall. Increasing levels of competition in the banking and financial services business may decrease our net interest margin by forcing us to offer lower lending interest rates and pay higher deposit interest rates. Although we believe our current level of interest rate sensitivity is reasonable, significant fluctuations in interest rates and increasing competition may have an adverse effect on our business, financial condition and results of operations.

A sustained decrease in market interest rates could adversely affect our earnings. When interest rates decline, borrowers tend to refinance higher-rate, fixed-rate loans at lower rates, prepaying their existing loans. Under those circumstances, we would not be able to reinvest those prepayments in assets earning interest rates as high as the rates on the prepaid loans. In addition, our commercial real estate and commercial loans, which carry interest rates that, in general, adjust in accordance with changes in the prime rate, will adjust to lower rates. We are also significantly affected by the level of loan demand available in our market. The inability to make sufficient loans directly affects the interest income we earn. Lower loan demand will generally result in lower interest income realized as we place funds in lower yielding investments.

Failure to successfully execute our strategy could adversely affect our performance.

Our financial performance and profitability depends on our ability to execute our corporate growth strategy. Continued growth, however, may present operating and other problems that could adversely affect our business, financial condition and results of operations. Accordingly, there can be no assurance that we will be able to execute our growth strategy or maintain the level of profitability that we have recently experienced. Factors that may adversely affect our ability to attain our long-term financial performance goals include those stated elsewhere in this section, as well as:

- Inability to control non-interest expense, including, but not limited to, rising employee, regulatory compliance, and healthcare costs;
- Inability to increase non-interest income; and
- Continuing ability to expand, through de novo branching or finding acquisition targets at valuation levels we find attractive.

Economic conditions in the Central Coast of California area could adversely affect our operations and/or cause us to sustain losses.

Our retail and commercial banking operations are concentrated primarily in San Luis Obispo and Santa Barbara Counties. As a result of this geographic concentration, our results of operations depend largely upon economic conditions in this area. A significant source of risk arises from the possibility that losses will be sustained if a significant number of our borrowers, guarantors and related parties fail to perform in accordance with the terms of their loans. This risk increases when the economy is weak. We have adopted underwriting and credit monitoring procedures and credit policies, including the establishment and review of the allowance for credit losses, that management believes is appropriate to minimize this risk by assessing the likelihood of nonperformance, tracking loan performance and diversifying our credit portfolio. These policies and procedures, however, may not prevent unexpected losses that could materially adversely affect our results of operations in general and the market value of our stock.

Our primary market area is an increasingly competitive and overcrowded banking market. Our ability to achieve the growth outlined in our corporate strategic goals may be dependent in part on an ability to grow through the successful addition of new branches or the identification and acquisition of potential targets at acceptable pricing levels either inside or outside of our primary market. If we are unable to attract significant new business through strategic branching, or acquire new business through our acquisition of other banks, our growth in loans and deposits and, therefore, our earnings, may be adversely affected.

We face strong competition from financial service companies and other companies that offer banking services that could hurt our business.

The financial services business in our market areas is highly competitive. It is becoming increasingly competitive due to changes in regulation, technological advances, and the accelerating pace of consolidation among financial services providers. We face competition both in attracting quality assets and deposits and in making loans. We compete for loans principally through the interest rates and loan fees we charge and the efficiency and quality of services we provide. Increasing levels of competition in the banking and financial services business may reduce our market share, decrease loan demand, cause the prices we charge for our services to fall, or decrease our net interest margin by forcing us to offer lower lending interest rates and pay higher deposit interest rates. Therefore, our results may differ in future periods depending upon the nature or level of competition.

Technology and other changes are allowing parties to complete financial transactions that historically have involved banks through alternative methods. For example, consumers can now maintain funds that would have historically been held as bank deposits in brokerage accounts or mutual funds. Consumers can also complete transactions such as paying bills and/or transferring funds directly without the assistance of banks. The process of eliminating banks as intermediaries, known as "disintermediation," could result in the loss of fee income, as well as the loss of customer deposits and the related income generated from those deposits. The loss of these revenue streams and the lower cost deposits as a source of funds could have a material adverse effect on our financial condition and results of operations.

We may not be able to attract and retain skilled people.

Our success depends, in large part, on our ability to attract and retain key people. Competition for the best people in most of our activities can be intense and we may not be able to hire people or to retain them. The unexpected loss of services of one or more of our key personnel could have a material adverse impact on our business because of their skills, knowledge of our market, years of industry experience and the difficulty of promptly finding qualified replacement personnel.

Our internal operations are subject to a number of risks.

We are subject to certain operations risks, including, but not limited to, data processing system failures and errors, customer or employee fraud and catastrophic failures resulting from terrorist acts or natural disasters. We maintain a system of internal controls to mitigate against such occurrences and maintain insurance coverage for such risks that are insurable, but should such an event occur that is not prevented or detected by our internal controls, uninsured or in excess of applicable insurance limits, it could have a significant adverse impact on our business, financial condition or results of operations.

Information Systems. We rely heavily on communications and information systems to conduct our business. Any failure, interruption or breach in security of these systems could result in failures or disruptions in our customer relationship management, general ledger, deposit, loan and other systems. While we have policies and procedures designed to prevent or limit the effect of the failure, interruption or security breach of our information systems, there can be no assurance that any such failures, interruptions or security breaches will not occur or, if they do occur, that they will be adequately addressed. The occurrence of any failures, interruptions or security breaches of our information systems could damage our reputation, result in a loss of customer business, subject us to additional regulatory scrutiny, or expose us to civil litigation and possible financial liability, any of which could have a material adverse effect on our financial condition and results of operations.

Technological Advances. The financial services industry is continually undergoing rapid technological change with frequent introductions of new technology-driven products and services. The effective use of technology increases efficiency and enables financial institutions to better serve customers and to reduce costs. Our future success depends, in part, upon our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands, as well as to create additional efficiencies in our operations. Many of our competitors have substantially greater resources to invest in technological improvements. We may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to our customers. Failure to successfully keep pace with technological change affecting the financial services industry could have a material adverse impact on our business and, in turn, our financial condition and results of operations.

Severe Weather, Natural Disasters, Acts of War or Terrorism and Other External Events. Severe weather, natural disasters, acts of war or terrorism and other adverse external events could have a significant impact on our ability to conduct business. Such events could affect the stability of our deposit base, impair the ability of borrowers to repay outstanding loans, impair the value of collateral securing loans, cause significant property damage, result in loss of revenue and/or cause us to incur additional expenses. For example, the Central Coast of California is subject to earthquakes and fires. Operations in our market could be disrupted by both the evacuation of large portions of the population as well as damage and or lack of access to our banking and operation facilities. While we have not experienced such an occurrence to date, other severe weather or natural disasters, acts of war or terrorism or other adverse external events may occur in the future. Although management has established disaster recovery policies and procedures, the occurrence of any such event could have a material adverse effect on our business, which, in turn, could have a material adverse effect on our financial condition and results of operations.

We depend on cash dividends from our subsidiary bank to meet our cash obligations.

As a holding company, dividends from our subsidiary bank provide a substantial portion of our cash flow used to service the interest payments on our trust preferred securities and our other obligations, including cash dividends. See “Item 5 – Market for Common Equity and Related Stockholder Matters.” Various statutory provisions restrict the amount of dividends our subsidiary bank can pay to us without regulatory approval.

<u>Risks Associated with our Industry.</u>

We are subject to government regulation that could limit or restrict our activities, which in turn could adversely impact our operations.

The financial services industry is regulated extensively. Federal and State regulation is designed primarily to protect the deposit insurance funds and consumers, and not to benefit our shareholders. These regulations can sometimes impose significant limitations on our operations.

New laws and regulations or changes in existing laws and regulations or repeal of existing laws and regulations may adversely impact our business. For example, operating expenses of approximately $161 thousand were attributable to compliance with the Sarbanes-Oxley Act provisions in the year ended December 31, 2006. We anticipate that continued compliance with, among other regulatory provisions, The Sarbanes-Oxley Act will impact future operating expenses.

Further, federal monetary policy, particularly as implemented through the Federal Reserve System, significantly affects economic conditions for us.

New legislative and regulatory proposals may affect our operations and growth.

Proposals to change the laws and regulations governing the operations and taxation of, and federal insurance premiums paid by, banks and other financial institutions and companies that control such institutions are frequently raised in the U.S. Congress, state legislatures and before bank regulatory authorities. The likelihood of any major changes in the future and the impact such changes might have on us or our subsidiaries are impossible to determine. Similarly, proposals to change the accounting treatment applicable to banks and other depository institutions are frequently raised by the SEC, the federal banking agencies, the IRS and other appropriate authorities. The likelihood and impact of any additional future changes in law or regulation and the impact such changes might have on us or our subsidiaries are impossible to determine at this time.

Risks Associated with our Stock.

Our Stock Trades Less Frequently Than Others.

Although our common stock is listed for trading on the NASDAQ Capital Market, the trading volume in our common stock is less than that of other larger financial services companies. A public trading market having the desired characteristics of depth, liquidity and orderliness depends on the presence in the marketplace of willing buyers and sellers of our common stock at any given time. This presence depends on the individual decisions of investors and general economic and market conditions over which we have no control. Given the lower trading volume of our common stock, significant sales of our common stock, or the expectation of these sales, could cause our stock price to fall.

Our Stock Price Is Affected by a Variety of Factors.

Stock price volatility may make it more difficult for you to resell your common stock when you want and at prices you find attractive. Our stock price can fluctuate significantly in response to a variety of factors discussed in this section, including, among other things:

- Actual or anticipated variations in quarterly results of operations.
- Recommendations by securities analysts.
- Operating and stock price performance of other companies that investors deem comparable to our company.
- News reports relating to trends, concerns and other issues in the financial services industry.
- Perceptions in the marketplace regarding our company and/or its competitors.

Our Common Stock Is Not An Insured Deposit.

Our common stock is not a bank deposit and, therefore, is not insured against loss by the FDIC, any other deposit insurance fund or by any other public or private entity. Investment in our common stock is inherently risky for the reasons described in this “Risk Factors” section and elsewhere in this report and is subject to the same market forces that affect the price of common stock in any company. As a result, if you acquire our common stock, you may lose some or all of your investment.

Our Articles Of Incorporation and By-Laws, As Well As Certain Banking Laws, May Have An Anti-Takeover Effect.

Provisions of our articles of incorporation, bylaws and federal banking laws, including regulatory approval requirements, could make it more difficult for a third party to acquire us, even if doing so would be perceived to be beneficial to our shareholders. The combination of these provisions may hinder a non-negotiated merger or other business combination, which, in turn, could adversely affect the market price of our common stock.

ITEM 1B. UNRESOLVED STAFF COMMENTS.
None

ITEM 2. DESCRIPTION OF PROPERTIES.

The company’s headquarters is located at 545 12^{th} Street in Paso Robles, California. It is an office owned and occupied solely by the bank. Additionally, the company owns and occupies a three story administrative facility from where all administrative functions are based. This facility is located at 1222 Vine Street in Paso Robles, California. The company also occupies 11 branches within the counties of San Luis Obispo and Santa Barbara. The bank currently owns 5 of the 12 branches that it occupies and leases the remaining 7 branches from various unaffiliated parties for an approximate aggregate amount of $67,704 per month. Additionally, the company subleases part or all of 3 branches to unaffiliated parties. The income associated with these subleases is approximately $16,450 per month.

The Company believes its facilities are adequate for its present needs. The Company believes that the insurance coverage on all properties is adequate. Most of the leases contain multiple renewal options and provisions for rental increases, principally for changes in the cost of living index, property taxes and maintenance.

ITEM 3. LEGAL PROCEEDINGS.

The Bank is, from time to time, subject to various pending and threatened legal actions which arise out of the normal course of its business. Neither the Company nor the Bank is a party to any pending material legal or administrative proceedings (other than ordinary routine litigation incidental to the Company's or the Bank's business).

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

None.

PART II

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

Market Information

The Company's Common Stock trades on the NASDAQ Capital Market under the symbol "HEOP."

The following table summarizes those trades of the Company's Common Stock on NASDAQ, setting forth the approximate high and low closing sales prices for each quarterly period ended since January 1, 2005.

Quarter Ended 2006	Closing Prices	
	High	Low
December 31,	$19.06	$16.36
September 30,	17.00	15.87
June 30,	19.53	16.50
March 31,	22.90	18.32

Quarter Ended 2005	Closing Prices	
	High	Low
December 31,	$21.40	$16.67
September 30,	17.00	14.33
June 30,	15.00	13.08
March 31,	15.23	12.79

Prices listed above have been adjusted to reflect all stock dividend and split activity.

Holders

As of February 1, 2006, there were approximately 1,815 holders of the Company's Common Stock. There are no other classes of equity securities outstanding.

Dividends

The Company is a legal entity separate and distinct from the Bank. The Company's shareholders are entitled to receive dividends when and as declared by its Board of Directors, out of funds legally available therefore, subject to the restrictions set forth in the California General Corporation Law (the "Corporation Law"). The Corporation Law provides that a corporation may make a distribution to its shareholders if the corporation's retained earnings equal at least the amount of the proposed distribution. The Corporation Law also provides that, in the event that sufficient retained earnings are not available for the proposed distribution, a corporation may nevertheless make a distribution to its shareholders if it meets two conditions, which generally stated are as follows: (i) the corporation's assets equal at least 1-1/4 times its liabilities, and (ii) the corporation's current assets equal at least its current liabilities or, if the average of the corporation's earnings before taxes on income and before interest expenses for the two preceding fiscal years was less than the average of the corporation's interest expenses for such fiscal years, then the corporation's current assets must equal at least 1-1/4 times its current liabilities. Refer to "Item 7. Management's Discussion and Analysis of Financial condition and Results of Operations" on junior subordinated debenture limitations on dividends.

The ability of the Company to pay a cash dividend and to service the debt on its junior subordinated debenture depends largely on the Bank's ability to pay a cash dividend to the Company. The payment of cash dividends by the Bank is subject to restrictions set forth in the California Financial Code (the "Financial Code"). The Financial Code provides that a bank may not make a cash distribution to its shareholders in excess of the lesser of (a) bank's retained earnings; or (b) bank's net income for its last three fiscal years, less the amount of any distributions made by the bank or by any majority-owned subsidiary of the bank to the shareholders of the bank during such period. However, a bank may, with the approval of the DFI, make a distribution to its shareholders in an amount not exceeding the greatest of (x) its retained earnings; (y) its net income for its last fiscal year; or (z) its net income for its current fiscal year. In the event that the DFI determines that the shareholders' equity of a bank is inadequate or that the making of a distribution by the bank would be unsafe or unsound, the DFI may order the bank to refrain from making a proposed distribution. The FDIC may also restrict the payment of dividends if such payment would be deemed unsafe or unsound or if after the payment of such dividends, the bank would be included in one of the "undercapitalized" categories for capital adequacy purposes pursuant to federal law. (See, "Item 1 - Description of Business - Prompt Corrective Action and Other Enforcement Mechanisms.") Additionally, while the Federal Reserve Board has no general restriction with respect to the payment of cash dividends by an adequately capitalized bank to its parent holding company, the Federal Reserve Board might, under certain circumstances, place restrictions on the ability of a particular bank to pay dividends based upon peer group averages and the performance and maturity of the particular bank, or object to management fees to be paid by a subsidiary bank to its holding company on the basis that such fees cannot be supported by the value of the services rendered or are not the result of an arm's length transaction.

Under these provisions, the amount available for distribution from the Bank to the Company was approximately $15.2 million at December 31, 2006.

The following table outlines stock dividend and stock split activity since 2000:

Stock Dividend Percentage	Record Date
5%	April 3, 2000
5%	March 16, 2001
5%	March 8, 2002
2 for 1 Split	August 2, 2002
5%	March 14, 2003
5%	April 9, 2004
5%	April 8, 2005
3 for 2 Split	November, 10 2005

Cash Dividends

On April 21, 2006, the Board of Directors of Heritage Oaks Bancorp, declared a special $0.25 cents per-share dividend for all shareholders of record on May 8, 2006, payable on May 19, 2006.

On July 21, 2006, the Board of Directors of Heritage Oaks Bancorp, declared the company's first quarterly cash dividend of $0.08 cents per-share for all shareholders of record on August 11, 2006, payable on August 25, 2006.

On October 20, 2006, the Board of Directors of Heritage Oaks Bancorp, the Board declared an $0.08 per-share quarterly cash dividend for all shareholders of record on November 3, 2006, payable on November 17, 2006.

Whether or not dividends will be paid in the future will be determined by the Board of Directors after consideration of various factors. The Company's profitability and regulatory capital ratios in addition to other financial conditions will be key factors considered by the Board of Directors in making such determinations regarding the payment of dividends by the Company.

Securities Authorized for Issuance Under Equity Compensation Plans

In May 2005, stockholders approved the Company's 2005 Equity Based Compensation Plan (the "2005 Plan"). The principal purpose of the 2005 Plan is to promote the success of the Company by providing an additional means to attract, motivate, retain and reward key employees and directors of the Company and its subsidiaries with stock options and other equity based incentives for high levels of individual performance and improved financial performance of the Company. The 2005 Plan provides no further grants may be made from the 1997 Stock Option Plan.

The 2005 Plan authorizes the granting of: Incentive Stock Options; Non-Qualified Stock Options; Stock Appreciation Rights; Restricted Stock Awards; Restricted Stock Units; and Performance Share Cash Only Awards. Vesting restrictions on awards may be time based and/or performance based; Participation in the 2005 Plan is limited to officers at the level of Vice President or above and other officers who provide substantial services to the Company as well as the Company's directors.

The following table summarizes information as of December 31, 2006 relating to equity compensation plans of the Company pursuant to which grants of options, restricted stock or other rights to acquire shares may be granted from time to time:

Plan Category	Plan Year	Number of securities to be issued upon exercise of outstanding options, warrants of rights	Weighted average exercise price of outstanding options, warrants of rights	Number of securities remaining available for future issuance
Equity compensation	1990	3,136	$2.55	-0-
plans approved by	1997	433,434	$5.45	-0-[1]
security holders	2005	66,050 [2]	$0.00	568,513
Equity compensation plans not approved by security holders		N/A	N/A	N/A
Total		502,620	$5.42	568,513

[1] No further grants may be made from the 1997 Stock Option Plan.
[2] The awards reflected in the table from the 2005 Plan were in the form of restricted stock grants. Restrictions lapse completely on the fifth anniversary date from issuance.

Purchases of Equity Securities

On July 21, 2006, the Company adopted a one year stock repurchase program in the initial amount of 40,000 shares and an expiration date of July 21, 2007. The repurchase program seeks to reduce the number of outstanding shares resulting in an improvement to the Company's earnings per share and to its return on equity**.** In October 2006, the Company approved an increase in the stock repurchase program to a total of 100,000 shares. The total number of shares repurchased in 2006 was 40,000. The average price per share paid during 2006 was $17.96. All of these shares were purchased at current market prices on the date of transaction in compliance with the SEC rules. As of December 31, 2006, the Company could repurchase up to an additional 60,000 shares under the July 2006 authorization.

The table below summarizes our monthly repurchases and redemptions of our common equity securities during the three months ended December 31st, 2006.

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Remaining Shares That May be Purchased Under the Authorization	
October 2006	--	--	85,000	1)
November 2006	10,000	$18.90	75,000	
December 2006	15,000	$18.72	60,000	
Fourth Quarter 2006 Totals	25,000	$18.79	60,000	

1) Includes the additional 60,000 shares added to the plan in October 2006

ITEM 6. SELECTED FINANCIAL DATA.

The table below provides selected financial data that highlights the Company's performance results for the five years ended December 31, 2006, 2005, 2004, 2003 and 2002.

Selected Financial Data

	For the Year Ended December 31,				
	2006	2005	2004	2003	2002
Results of Operations	(Dollars in thousands except per share and ratio data)				
Total Interest Income	$ 36,372	$ 30,175	$ 23,313	$ 18,174	$ 16,035
Total Interest Expense	9,316	5,016	3,361	3,463	3,491
Net Interest Income	27,056	25,159	19,952	14,711	12,544
Provision for Possible Loan Losses	600	710	410	370	545
Net Interest Income after Provision for Possible Loan Losses	26,456	24,449	19,542	14,341	11,999
Total Non-Interest Income	4,952	5,009	4,999	3,797	3,463
Total Non-Interest Expenses	20,955	18,718	17,198	12,425	11,074
Income Before Income Tax Provision	10,453	10,740	7,343	5,713	4,388
Provision for Income Taxes	3,791	4,103	2,759	2,117	1,649
Net Income	$ 6,662	$ 6,637	$ 4,584	$ 3,596	$ 2,739
Earnings Per Share					
Basic:	$ 1.05	$ 1.08	$ 0.77	$ 0.71	$ 0.57
Diluted:	$ 1.01	$ 1.01	$ 0.71	$ 0.67	$ 0.52
Financial Condition					
Total Assets	$ 541,774	$ 488,501	$ 448,012	$ 441,948	$ 337,511
Net Loans	$ 439,277	$ 362,635	$ 334,964	$ 274,051	$ 187,311
Deposits	$ 420,521	$ 417,797	$ 370,441	$ 366,439	$ 264,178
Shareholder's Equity	$ 49,472	$ 44,845	$ 37,250	$ 32,288	$ 19,813
Selected Financial Ratios					
Return on Average Assets	1.32%	1.38%	1.02%	1.05%	0.98%
Return on Average Equity	14.10%	16.06%	13.15%	15.52%	15.56%
Return on Average Tangible Equity	16.22%	19.11%	16.61%	16.39%	15.56%
Average Equity to Average Assets	9.37%	8.61%	7.79%	6.76%	6.33%
Efficiency Ratio [1]	65.47%	62.04%	68.93%	67.13%	69.18%
Dividend Payout Ratio	39.05%	-	-	-	-

[1] The efficiency ratio is defined as total non-interest expense as a percent of the combined net interest income plus non-interest income.

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

The following is an analysis of the financial condition and results of operations of the Company for the three years ended December 31, 2006. The analysis should be read in connection with the consolidated financial statements and notes thereto appearing elsewhere in this report.

Executive Summary

Both changes in short term interest rates as well as changes to the shape of the yield curve influence the Company and its markets. Generally, in 2006 increases in longer term interest rates were not commensurate with the rise in short term interest rates that has occurred since June 2004 resulting in smaller differentials between long and short term interest rates. This effect first created a flattening yield curve that has since become inverted, that is to say, short term rates are higher than long term rates. The effects of the inverted yield curve can be wide ranging, but generally, it has been credited for slowing the housing market and economy.

The Company's earnings are highly influenced by changes in short term interest rates. The nature of the Company's balance sheet can be summarily described as of short duration and asset sensitive. The balance sheet is of short duration because a large percentage of its interest sensitive assets and liabilities re-price immediately with changes in the Federal Funds and Prime interest rates. The Company is asset sensitive, primarily due to its large volume of non-interest bearing demand deposit accounts which effectively never re-price. Therefore, an upward movement in short term interest rates will generally result in higher net interest margin and, conversely, a reduction in short term interest rates will result in reduced net interest margin.

Beginning in January 2001 and continuing through July 2003, actions by the Federal Reserve Bank (the "FRB") to cut target interest rates resulted in the Prime Rate being reduced from 9.50% to 4.00%. Beginning in June 2004 through December 2006, the FRB increased the Prime Rate from 4.00% to 8.25%.

Historically, the largest and most variable source of income for the Company is net interest income. The results of operations for the years 2006, 2005 and 2004 reflect the impact of changes in short term rates as well as growth in the volume of both interest earning assets and interest bearing liabilities during these periods.

During 2006, the steady increase in the Prime Rate was the primary driver of the Company's 16 basis point increase in net interest margin, from 5.78% to 5.94% compared to a 68 basis point increase during 2005 and a 28 basis point increase for 2004. The declining increase, year over year, in the net interest margin is primarily due to disintermediation and the migration of lower cost deposits to higher yielding alternative deposits and the need to use borrowed funds, which typically are a more costly source of funding than deposits.

In 2006 earnings were influenced by loan growth increasing net interest income, however, net income remained relatively unchanged year over year due to a significant rise in interest expense coupled with higher operating expenses.

At the end of 2005 the Company began a branding initiative which included an extensive assessment, both internally and externally of all bank delivery channels. Recommended actions were incorporated into a comprehensive Marketing Strategic Plan which is currently in process of implementation. The increase in non-interest expense has been primarily the result of expenses related to the branding project, the addition of staff including the EVP / Human Resources and EVP/Product Delivery and full service branch expansion within the bank's existing footprint in the town of Templeton. The Company has invested significant resources in these new initiatives throughout 2006 in an effort to improve our service delivery and image and expect to continue the investment in 2007 with the expectation of returns on these investments adding to shareholder value.

Results of Operations

The Company reported net income of $6.7 million for the year ended December 31, 2006 compared to $6.6 million and $4.6 million for the years 2005 and 2004 respectively. This represents a nominal increase for 2006 over 2005 and 45% for 2005 over 2004. Basic earnings per share were $1.05, $1.08 and $0.77 at December 31, 2006, 2005 and 2004, respectively. Diluted earnings per share were $1.01, $1.01 and $0.71 at December 31, 2006, 2005 and 2004, respectively. The earnings were mostly unchanged in 2006 primarily due to an increase in interest expense on interest bearing accounts and borrowed funds along with an increase in salary and employee expenses. The increase in earnings for 2005 over 2004 was primarily attributable to an interest rate environment favorable to the Company's asset-sensitive balance sheet.

Net Interest Income and Interest Margin

Net interest income, the primary component of the net earnings of a financial institution, refers to the difference between the interest paid on deposits and borrowings, and the interest earned on loans and investments. The net interest margin is the amount of net interest income expressed as a percentage of average earning assets. Factors considered in the analysis of net interest income are the composition and volume of earning assets and interest-bearing liabilities, the amount of non-interest bearing liabilities and non–accrual loans, and changes in market interest rates.

The table below sets forth the average balance sheet information, interest income and expense, average yields and rates and net interest income and margin for the years ended December 31, 2006, 2005 and 2004. The average balance of non-accruing loans has been included in loan totals.

AVERAGE BALANCE SHEET INFORMATION

(dollars in thousands)	For the year ending December 31,								
	2006			2005			2004		
	Avg.	Yield/	Amt.	Avg.	Yield/	Amt.	Avg.	Yield/	Amt.
Interest Earning Assets:	Balance	Rate	Interest	Balance	Rate	Interest	Balance	Rate	Interest
Interest bearing deposits with other banks	$ 2,267	6.66%	$ 151	$ 1,149	4.44%	$ 51	$ 2,154	1.90%	$ 41
Investment securities taxable	25,503	4.25%	1,083	38,499	3.81%	1,465	49,178	3.76%	1,849
Investment securities non-taxable	16,319	4.30%	702	13,701	4.33%	593	11,511	4.40%	506
Federal funds sold	11,179	4.82%	539	19,529	3.42%	667	24,287	1.24%	302
Loans (1) (2)	400,229	8.47%	33,897	362,735	7.55%	27,399	304,402	6.77%	20,615
Total interest earning assets	455,497	7.99%	36,372	435,613	6.93%	30,175	391,532	5.95%	23,313
Allowance for possible loan losses	(3,931)			(3,577)			(3,158)		
Other assets	52,311			48,168			59,054		
TOTAL ASSETS	$ 503,877			$ 480,204			$ 447,428		
Interest -bearing liabilities:									
Savings/NOW/money market	160,841	1.55%	2,497	167,223	1.01%	1,695	158,291	0.44%	699
Time deposits	106,342	4.21%	4,472	65,128	2.74%	1,784	69,715	1.54%	1,071
Other borrowings	27,854	5.21%	1,452	27,966	3.41%	954	31,023	3.72%	1,155
FF Purchased	1,020	5.49%	56	-	-	-	-	-	-
Long Term Debt	9,694	8.65%	839	8,248	7.07%	583	8,248	5.29%	436
Total interest-bearing liabilities	305,751	3.05%	9,316	268,565	1.87%	5,016	267,277	1.26%	3,361
Demand deposits	146,458			166,780			142,796		
Other liabilities	4,432			3,519			2,501		
Stockholders' equity									
Common stock	29,367			28,049			23,071		
Retained earnings	18,003			13,268			11,510		
Valuation Allowance Investments	(134)			23			273		
Total stockholders' equity	47,236			41,340			34,854		
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 503,877			$ 480,204			$ 447,428		
Net Interest Income			$27,056			$25,159			$19,952
Net Interest Margin (3)		5.94%			5.78%			5.10%	

(1) Nonaccrual loans have been included in total loans.

(2) Loan fees of $1,275, $1,044 and $1,021, for 2006, 2005 and 2004, respectively have been included in the interest income computation.

(3) Net interest income has been calculated by dividing the net interest income by total average earning assets.

The following table provides a summary of the changes in interest income and interest expense related to changes in interest rates and volume for the years ended December 31, 2006, 2005, 2004.

RATE/VOLUME ANALYSIS

	2006			2005			2004		
Increase (decrease) in:	Average Bal/Vol	Average Rate	Total	Average Bal/Vol	Average Rate	Total	Average Bal/Vol	Average Rate	Total
Interest income:									
Loans (1)	$ 986	$ 5,512	$ 6,498	$ 5,104	$ 1,680	$ 6,784	$ 5,293	$ (608)	$ 4,685
Investment securities taxable	(537)	155	(382)	(401)	17	(384)	242	108	350
Investment securities non-taxable (2):	172	(7)	165	147	(15)	132	94	(15)	79
Taxable equivalent adjustment (2):	(58)	2	(56)	(50)	5	(45)	(32)	5	(27)
Interest-bearing deposits	172	(21)	151	(19)	29	10	29	(1)	28
Federal funds sold	(333)	154	(179)	(59)	424	365	(14)	38	24
Total	401	5,796	6,197	4,722	2,140	6,862	5,612	(473)	5,139
Interest expense:									
Savings, now, money market	(67)	869	802	39	957	996	216	(142)	74
Time deposits	5,080	(2,392)	2,688	(70)	783	713	414	(469)	(55)
Other borrowings	(4)	502	498	(3)	(198)	(201)	(15)	(117)	(132)
FF Purchased	56	-	56	-	-	-	-	-	-
Long term borrowings	17	239	256	-	147	147	13	(2)	11
Total	5,082	(782)	4,300	(34)	1,689	1,655	628	(730)	(102)
Increase (decrease) in net Interest income	$ (4,682)	$ 6,578	$ 1,897	$ 4,756	$ 451	$ 5,207	$ 4,984	$ 257	$ 5,241

(1) Loan fees of $1,275, $1,440 and $1,021, for 2006, 2005 and 2004, respectively have been included in the interest income computation.

(2) Adjusted to a fully taxable equivalent basis using a tax rate of 34%.

Note A: Average balances of all categories in each period were included in the volume computations.

Note B: Average yield rates in each period were used in rate computations. Change attributable to both volume and rate have been allocated in proportion to the relationship between their absolute dollar amounts.

During 2006 there was a $6.2 million increase in interest income and a $4.3 million increase in interest expense compared to 2005. The resulting $1.9 million increase in net interest income was the result of a number of dynamics affecting both average balance and interest rate considerations. The Company experienced an increase in its average earning assets outstanding of $19.9 million. This increase was primarily attributable to the net increase in average loans, which were up by $37.5 million. The increase in loans was partially offset by decreases in average federal funds sold of $8.4 million and taxable investment securities of $13 million. Average interest bearing liabilities increased by $37.2 million while non-interest bearing demand deposits decreased by $20.3 million during this period. In addition, earning asset yields were approximately 106 basis points higher in 2006 compared to 2005 while the cost of interest bearing liabilities increased by 118 basis points.

During 2005 there was a $6.9 million increase in interest income and a $1.7 million increase in interest expense compared to 2004. The resulting $5.2 million increase in net interest income was the result of a number of dynamics affecting both average balance and interest rate considerations. The Company experienced an increase in its average earning assets outstanding of $44.1 million. This increase was primarily attributable to the net increase in average loans, which were up by $58.3 million. The increase in loans was partially offset by decreases in average federal funds sold of $4.8 million and taxable investment securities of $10.7 million. Also, average interest bearing liabilities increased by $1.3 million, significantly less than the increase in earning assets. Non-interest bearing demand deposits increased by $23.9 million during this period and provided low-cost funding for the growth in earning assets. In addition, earning asset yields were approximately 100 basis points higher in 2005 compared to 2004 while deposit costs excluding demand deposits increased 61 basis points.

The hypothetical impacts of sudden interest rate movements applied to the Company's asset and liability balances are modeled monthly. The results of this movement indicate how much of the Company's net interest income is "at risk" from various rate changes over a one year horizon. This exercise is valuable in identifying risk exposures. The results for the Company's December 31, 2006 balances indicate that the net interest income at risk over a one year time horizon from a 1.0% and 2.0% upward and downward rate movement are within the Company's policy guidelines for such changes. See, "Item 7A - Quantitative and Qualitative Disclosures about Market Risk."

The tables below set forth changes from 2005 to 2006 for average interest earning assets and their respective average yields.

(dollars in thousands)	Average Balance for the year ending 31-Dec		$	%	Average Yield for the year ending 31-Dec		
Interest Earning Assets:	2006	2005	Variance	Variance	2006	2005	Variance
Time deposits with other banks	$ 2,267	$ 1,149	$ 1,118	97.30%	6.66%	4.44%	2.22%
Investment securities taxable	25,503	38,499	(12,996)	-33.76%	4.25%	3.81%	0.44%
Investment securities non-taxable	16,319	13,701	2,618	19.11%	4.30%	4.33%	-0.03%
Federal funds sold	11,179	19,529	(8,350)	-42.76%	4.82%	3.42%	1.40%
Loans (1) (2)	400,229	362,735	37,494	10.34%	8.47%	7.55%	0.92%
Total interest earning assets	$ 455,497	$ 435,613	$ 19,884	4.56%	7.99%	6.93%	1.06%

(1) Nonaccrual loans have been included in total loans.
(2) Loan fees of $1,275, $1,440 and $1,021, for 2006, 2005 and 2004, respectively have been included in the interest income computation.

The tables below sets forth changes from 2005 to 2006 for average interest bearing liabilities and their respective average rates paid.

(dollars in thousands)	Average Balance for the year ending 31-Dec		$	%	Average Rate for the year ending 31-Dec		
Interest bearing liabilities:	2006	2005	Variance	Variance	2006	2005	Variance
Savings/NOW/money market	$ 160,841	$ 167,223	$ (6,382)	-3.82%	1.55%	1.01%	0.54%
Time deposits	106,342	65,128	41,214	63.28%	4.21%	2.74%	1.47%
Other borrowings (1) (2)	27,854	27,966	(112)	-0.40%	5.21%	3.41%	1.80%
FF Purchased	1,020	-	1,020	0.00%	5.49%	0.00%	5.49%
Long Term Debt	9,694	8,248	1,446	17.53%	8.65%	7.07%	1.58%
Total interest-bearing liabilities	$ 305,751	$ 268,565	$ 37,186	13.85%	3.05%	1.87%	1.18%

(1) Consists of FHLB Borrowings of $25,973 and Repurchase Agreements of $1,881
(2) Average Rate Paid of 5.25% on FHLB Borrowings and 4.63% on Repurchase Agreements

Non-Interest Income

The table below sets forth changes from 2005 to 2006 and 2004 to 2005 for non-interest income exclusive of gains on sale of securities, SBA loans and premises.

Non-Interest Income Components

	For the Year Ended December 31,			
(dollars in thousands)	**2006**	**2005**	**$ Variance**	**% Variance**
Service Charges on Deposit Accounts	$ 2,427	$ 2,430	$ (3)	-0.1%
ATM/Debit Card Transaction/Interchange Fees	711	629	82	13.0%
Bancard	122	160	(38)	-23.8%
Mortgage Origination Fees	552	897	(345)	-38.5%
Earnings on Cash Surrender Value Life Ins	393	323	70	21.7%
Other	737	482	255	52.9%
TOTAL	**$ 4,942**	**$ 4,921**	**$ 21**	**0.4%**

	For the Year Ended December 31,			
(dollars in thousands)	**2005**	**2004**	**$ Variance**	**% Variance**
Service Charges on Deposit Accounts	$ 2,430	$ 2,173	$ 257	11.8%
ATM/Debit Card Transaction/Interchange Fees	629	583	46	7.9%
Bancard	160	116	44	37.9%
Mortgage Origination Fees	897	602	295	49.0%
Earnings on Cash Surrender Value Life Ins	323	294	29	9.9%
Other	482	446	36	8.1%
TOTAL	**$ 4,921**	**$ 4,214**	**$ 707**	**16.8%**

For 2006 compared to 2005, total non interest income remained relatively unchanged seeing a year over year increase of only 0.4%.

Mortgage Origination Fees decreased in 2006 in comparison to 2005 due primarily to a decrease in mortgage volumes as a result of increasing interest rates and a leveling of property values in the region. Management is very aware that the revenue generated by this line of business is impacted by rate volatility and that if rates continue to rise or the availability of credit is diminished, then mortgage volumes at the Company could decline and impact the level of mortgage origination fee income. To mitigate material decreases in net revenue from this line of business, Management has taken steps to ensure that fixed costs are minimal due to commission based remuneration.

For 2005 compared to 2004, increases in Service Charges on Deposit Accounts were generally commensurate with and primarily due to deposit growth.

Mortgage Origination Fees increased in 2005 in comparison to 2004 due primarily to increased mortgage volumes as a result of decreasing interest rates and the availability of credit to mortgage consumers.

Non-Interest Expenses

The table below sets forth changes in non-interest expense for 2006, 2005, and 2004.

Non-Interest Expense Components

(dollars in thousands)	For the Year Ended December 31, 2006	2005	$ Variance	% Variance
Salaries and Employee Benefits	$ 11,573	$ 9,746	$ 1,827	18.7%
Occupany and Equipment	2,607	2,491	116	4.7%
Data Processing	2,138	2,200	(62)	-2.8%
Advertising and promotional	851	582	269	46.2%
Regulatory fees	112	106	6	5.7%
Other professional fees and outside services	1,207	802	405	50.5%
Legal fees and other litigation expense	154	122	32	26.2%
Loan Department Costs	147	182	(35)	-19.2%
Stationery and supplies	327	311	16	5.1%
Director fees	290	247	43	17.4%
Core Deposit Intangible Amortization	300	573	(273)	-47.6%
Other	1,249	1,356	(107)	-7.9%
	$ 20,955	**$ 18,718**	**$ 2,237**	**12.0%**

(dollars in thousands)	For the Year Ended December 31, 2005	2004	$ Variance	% Variance
Salaries and Employee Benefits	$ 9,746	$ 8,457	$ 1,289	15.2%
Occupany and Equipment	2,491	2,570	(79)	-3.1%
Data Processing	2,200	2,570	(370)	-14.4%
Advertising and promotional	582	515	67	13.0%
Regulatory fees	106	114	(8)	-7.0%
Other professional fees and outside services	802	530	272	51.3%
Legal fees and other litigation expense	122	76	46	60.5%
Loan Department Costs	182	181	1	0.6%
Stationery and supplies	311	374	(63)	-16.8%
Director fees	247	179	68	38.0%
Core Deposit Intangible Amortization	573	421	152	36.1%
Other	1,356	1,211	145	12.0%
	$ 18,718	**$ 17,198**	**$ 1,520**	**8.8%**

Salary/Related Expense

Salaries and employee related expense incurred the greatest dollar increase of any non-interest expense category during both 2006 and 2005. For the year ended December 31, 2006, the primary sources of the increase in this category were salaries and higher group insurance costs. These increases are due in part to expansion of our Executive Management team contributing to higher officer salaries and also an increase in full and part time employee salaries all related directly to the growth and profitability of the bank. Full time equivalent (FTE) employees increased from 170 at December 31, 2004 to 186 at December 31, 2005 and to 212 at December 31, 2006.

The bonus accrual for 2006 was approximately 40% less in 2006 compared to 2005. Bonus and commissions expense increases during 2004 and 2005 were influenced by the Company’s commitment to incentive based pay. Management believes that incentive based pay is a significant part of the Company’s corporate culture and has served to help provide above average return to shareholders. All employees participate either on a monthly, quarterly or annual basis.

Group insurance costs increased by approximately $223 thousand in 2006 and $160 thousand in 2005. The Company has made efforts to contain these costs while at the same time ensuring that employees receive appropriate and fair consideration.

Occupancy and Equipment

Occupancy and equipment expense increased in 2006 due to branch expansion in the town of Templeton and the completion of the administrative building that has been under construction since late 2004. The Company was able to eliminate two leased facilities and consolidate administrative operations in the new structure that was occupied in June 2006.

Occupancy and equipment expense decreased $78 thousand in 2005 compared to 2004. In July 2005 the Company entered into a sale-leaseback transaction of its branch office in the city of Atascadero. The sale price was $900 thousand and resulted in a gain to the Company of approximately $283 thousand which will be amortized into income over the term of the leaseback. While this transaction increases occupancy expense, the net income statement effect of the sale-leaseback will be a reduction in the net monthly cost of operating the branch.

Data Processing Expense

Data processing expense remained relatively unchanged between 2005 and 2006 seeing a slight 2.8% decrease year over year. Data processing expense declined $370 thousand in 2005 compared to 2004. The primary cause of the decline was $540 thousand of non-recurring expenses in 2004 related to the March 2005 final conversion of Hacienda's core and other ancillary processing services into the Bank's systems. Nearly 83% of this conversion cost is being saved over 18 months via a credit from its current data processing vendor of $25 thousand per month. In addition, the conversion allowed the Company to discontinue incurring Hacienda's legacy data processing costs beginning in March 2005. The Company ceased receiving this monthly credit in October 2006.

Other Professional Fees and Outside Services

The Company incurred $1,207 thousand in other professional fees and outside services during 2006. These expenses increased by $405 thousand and $272 thousand in 2006 and 2005 respectively. The increase for 2006 was attributable to higher audit and tax accounting costs, attorney's fees, consulting fees associated with branch expansion, compensation compliance and compliance with the Sarbanes-Oxley Act, Section 404.

Core Deposit Intangible Amortization

Following the acquisition of Hacienda in late 2003 the Company incurred significantly higher core deposit intangible amortization during 2005 and 2004. The Company chose to amortize the Hacienda-related intangibles by utilizing an amortization schedule in accordance with FAS 141 and FAS 142. In accordance with this schedule, the Company has incurred less expense in 2006 than in 2005 or 2004. Pursuant to the amortization schedule, the expense for 2007 is estimated to be $354 thousand compared to $300 thousand in 2006.

Provision for Income Taxes

The provision for income taxes was 36.3%, 38.2% and 37.6% of net pre-tax income for years ended December 31, 2006, 2005 and 2004, respectively. The decrease in effective rate for 2006 was due to analysis associated with FASB 109. The Company expects the effective tax rate to be approximately 38% for 2007.

Provision and Allowance for Credit Losses

An allowance for loan losses has been established by management to provide for those loans that may not be repaid in their entirety for a variety of reasons. The allowance is maintained at a level considered by management to be adequate to provide for probable incurred losses. The allowance is increased by provisions charged to earnings and is reduced by charge-offs, net of recoveries. The provision for loan losses is based upon past loan loss experience and management's evaluation of the loan portfolio under current economic conditions. Loans are charged to the allowance for loan losses when, and to the extent, they are deemed by management to be un-collectible. The allowance for loan losses is composed of allocations for specific loans and a historical portion for all other loans.

The Bank recognizes that credit losses will be experienced and the risk of loss will vary with, among other things, general economic conditions; the type of loan being made; the creditworthiness of the borrower over the term of the loan and in the case of a collateralized loan, the quality of the collateral for such loan. The allowance for loan loss represents the Bank's estimate of the allowance necessary to provide for probable incurred losses in the portfolio.

In making this determination, the Bank analyzes the ultimate collectibility of the loans in the portfolios by incorporating feedback provided by internal loan staff, an independent loan review function, and information provided by examinations performed by regulatory agencies. The Bank makes monthly evaluations as to the adequacy of the allowance for loan losses.

The analysis of the allowance for loan losses is comprised of three components; specific credit allocation; general portfolio allocation; and subjectively by determined allocation. Effective January 1, 1995 the Bank adopted Statement of Financial Accounting Standards No.114, Accounting by Creditors for Impairment of a Loan (SFAS 114), as amended by SFAS No. 118, Accounting by Creditors for Impairment of a Loan - Income Recognition and Disclosures. These pronouncements provide that when it is probable that a creditor will be unable to collect all amounts due in accordance with the terms of the loan that such loan is deemed impaired. Impaired loans are accounted for differently in that the amount of the impairment is measured and reflected in the records of the creditor. The allowance for credit losses related to loans that are identified for evaluation in accordance with Statement 114 is based on discounted cash flows using the loan's initial effective interest rate or the fair value of the collateral for certain collateral dependent loans. The general portfolio allocation consists of an assigned reserve percentage based on the credit rating of the loan. The subjective portion is determined based on loan history and the Banks' evaluation of various factors including current economic conditions and trends in the portfolio including delinquencies and impairment, as well as changes in the composition of the portfolio.

The allowance for loan losses is based on estimate, and ultimate losses will vary from current estimates. These estimates are reviewed monthly by the Bank's Director's Loan Committee and full Board of Directors, and as adjustments, either positive or negative, become necessary, a corresponding increase or decrease is made in the provision for loan losses. The methodology used to determine the adequacy of the allowance for possible loan losses for the year 2006 is consistent with prior periods.

The Bank's provision for loan losses was $600 thousand, $710 thousand and $410 thousand for 2006, 2005 and 2004 respectively. The loan loss provision represents coverage for general loan portfolio growth and real estate concentrations. Net loan charge-offs (loans charged off, net of loans recovered) were $400 thousand for 2006, $76 thousand for 2005 and $233 thousand for 2004. Losses in 2006 came primarily from a single loan charge off and the general loan portfolio continues to show sound loan underwriting. The allowance for credit losses as a percent of total gross loans at year-end 2006, 2005 and 2004 was 0.92%, 1.05% and 0.96%, respectively.

Loans are placed on non-accrual when a loan is specifically determined to be impaired or when principal or interest is delinquent for 90 days or more. Any unpaid interest previously accrued on those loans is reversed from income. Interest income generally is not recognized on specific impaired loans unless the likelihood of further loss is remote. Interest payments received on such loans are applied as a reduction on the loan principal balance.

Loans on non-accrual status totaled $55 thousand, $54 thousand and $872 thousand at December 31, 2006, 2005 and 2004, respectively. The decrease in non-accrual totals was the result of resolving several loan situations. Typically, these loans have adequate collateral protection and/or personal guaranties to provide a source of repayment to the Bank. The loans on non-accrual are related to several commercial loans that are being addressed by specific workout plans at this time. Interest income that would have been recognized on non-accrual loans if they had performed in accordance with the terms of the loans was approximately $63 thousand, $87 thousand and $126 thousand for the period ended December 31, 2006, 2005 and 2004, respectively.

Non-performing loans include non-accrual loans, restructured loans and accruing loans that are 90 days or more delinquent. The Bank had no loans that were 90 days or more delinquent and still accruing interest at December 31, 2006. Total non-performing loans were $55 thousand and $54 thousand at December 31, 2006 and December 31, 2005 respectively.

The following table summarizes the analysis of the allowance for loan losses as of December 31, 2006, 2005, 2004, 2003 and 2002:

Analysis of Allowance for Loan Losses

(in thousands)

	2006	2005	2004	2003	2002
Balance at Beginning of Period	$ 3,881	$ 3,247	$ 3,070	$ 2,336	$ 1,744
Balance of Hacienda Bank at					
Beginning of Period	-	-	-	597	-
Charge-offs:					
Commercial, Fianacial and Agricultural	508	86	202	463	76
Real Estate- Construction	-	-	-	-	-
Commercial Real Estate	-	-	-	-	-
Installment Loans to Individuals:	44	12	29	-	-
Money Plus	9	2	5	3	5
Credit Cards	-	-	-	-	-
Other Installment	-	-	-	-	-
Total charge-offs	561	100	236	466	81
Recoveries:					
Commercial, Fianacial and Agricultural	101	-	1	232	127
Real Estate- Construction	-	-	-	-	-
Real Estate-Mortgage	-	-	-	-	-
Installment Loans to Individuals:	56	24	2	1	-
Money Plus	4	-	-	-	1
Credit Cards	-	-	-	-	-
Other Installment	-	-	-	-	-
Total recoveries	161	24	3	233	128
Net Charge-offs	400	76	233	233	(47)
Additions Charged to Operations	600	710	410	370	545
Balance at End of Period	4,081	3,881	3,247	3,070	2,336
Gross Loans at End of Period	$ 444,983	$ 368,133	$ 339,693	$ 278,135	$ 190,469
Ratio of Net Charge-offs During the Year to Average Loans outstanding	0.10%	0.02%	0.08%	0.10%	-0.03%
Ratio of Reserves to Gross Loans	0.92%	1.05%	0.96%	1.10%	1.23%
Ratio of Non-performing Loans to the Allowance for Credit Losses	1.35%	1.39%	28.77%	50.20%	57.62%

Allocation of the Allowance for Loan Losses

(dollars in thousands)	2006 Amount	2006 % Total Loans	2005 Amount	2005 % Total Loans	2004 Amount	2004 % Total Loans	2003 Amount	2003 % Total Loans	2002 Amount	2002 % Total Loans
Commercial, Fianacial and Agricultural	$ 779	19%	$ 633	16%	$ 475	15%	$ 541	18%	$ 494	21%
Real Estate- Construction	969	24%	812	21%	641	20%	527	17%	498	21%
Commercial Real Estate	2,177	53%	2,221	57%	1,934	60%	1,793	58%	1,178	50%
Home Equity Lines of Credit	99	2%	152	4%	141	4%	148	5%	116	5%
Installment Loans to Individuals	51	1%	59	2%	53	2%	57	2%	47	2%
All Other Loans (including overdrafts)	5	0%	4	0%	3	0%	4	0%	3	0%
Total	$ 4,081	100%	$ 3,881	100%	$ 3,247	100%	$ 3,070	100%	$ 2,336	100%

Financial Condition

Total assets of the Company were $541.8 million at December 31, 2006 compared to $488.5 million at December 31, 2005, this represents an increase of $53.3 million or 11.0%. A favorable lending environment allowed the Company to increase net loans by $76.6 million. The investment portfolio trended downward during the year primarily due to prepayments on mortgage-backed securities. The portfolio ended 2006 with a book value $6.0 million less than at December 31, 2005.

The growth in assets was fueled by robust loan growth. Deposits remained relatively unchanged from 2005, and as a result the loan growth was funded mainly by additional borrowing from the FHLB. FHLB advances grew by $40.0 million from 2005 totaling $50.0 million at 2006 year end.

Earning assets as a percent of total assets was 90.4% at December 31, 2006 compared to 93.6% and 91.6% at December 31, 2005 and 2004 respectively.

For 2005, total assets increased by $40.5 million or 9.0%. The major contributing factor to this growth was due to growth in loans of $27.7 million. The growth in loans for 2005 can be attributed to a continued favorable interest rate environment.

The bank was able to fund the majority of the loan growth in 2005 by an increase in deposits of $47.4 million, $20.6 million of which were low or no cost Demand Deposits.

Earning assets as a percent of total assets was 93.6% at December 31, 2005 compared to 91.6% at December 31, 2004. In addition to the increase in the percent of earning assets, the change in the mix was such that a large portion of low yielding Fed Funds Sold moved into higher yielding loans.

Loans

A significant portion of total assets is the Company's gross loans that were $445.0 million and $368.1 million at December 31, 2006 and 2005, respectively. Approximately 60% of gross loans at December 31, 2006 re-price within one year. If interest rates change, the yield on the loans that renew or re-price according to their terms, will also change. The Company has an Asset/Liability Management system that models various interest rate environments for all rate sensitive assets and liabilities. In a 100 basis point increase action by the FRB, the model indicates that the net interest income would increase by approximately $1.6 million while a 100 basis point decline would decrease net interest income by $1.7 million.

The table below sets forth the composition of the loan portfolio as of December 31, 2006, 2005, 2004, 2003 and 2002.

COMPOSITION OF LOAN PORTFOLIO

(dollars in thousands)

	2006		2005		2004		2003		2002	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
Commercial, Financial and Agricultural	$ 84,976	19%	$ 60,050	16%	$ 49,584	15%	$ 49,024	18%	$ 40,373	21%
Real Estate- Construction	105,712	24%	76,981	21%	66,833	20%	47,720	17%	40,723	21%
Commercial Real Estate	237,401	53%	210,690	57%	202,765	60%	162,463	58%	96,324	50%
Home Equity Lines of Credit	10,792	2%	14,398	4%	14,708	4%	13,417	5%	10,486	5%
Installment Loans to Individuals	5,598	1%	5,620	2%	5,538	2%	5,173	2%	2,291	2%
All Other Loans (including overdrafts)	504	0%	394	0%	265	0%	338	0%	272	0%
Total Loans, Gross	444,983	100%	368,133	100%	339,693	100%	278,135	100%	190,469	100%
Deferred Loan Fees	(1,625)		(1,617)		(1,482)		(1,014)		(822)	
Reserve for Possible Loan Losses	(4,081)		(3,881)		(3,247)		(3,070)		(2,336)	
Total Loans, Net	$ 439,277		$ 362,635		$ 334,964		$ 274,051		$ 187,311	
Loans Held For Sale	$ 1,764		$ 3,392		$ 2,253		$ 4,402		$ 8,166	

The following are the approximate maturities and sensitivity to change in interest rates for the loan portfolio at December 31, 2006.

The following are the approximate maturities and sensitivity to change in interest rates for the loan portfolio at December 31, 2006

(in thousands)	Due Within 3 months or less	Due Over 3 mos through 12 months	Due Over 12 mo through 3 yrs	Due Over 3 yrs through 5 yrs	Due Over 5 yrs through 15 yrs	Due Over 15 yrs	Total
Fixed Rate Loans							
Commercial, Financial and Agricultural	$ 1,398	$ 2,611	$ 2,843	$ 5,372	$ 4,026	$ -	$ 16,250
Real Estate- Construction	6,948	8,944	3,961	18	3,500	-	23,371
Commercial Real Estate	1,763	139	4,564	6,108	64,638	5,010	82,222
Home Equity Lines of Credit	-	-	-	-	-	-	-
Installment Loans to Individuals	149	116	603	1,193	2,419	194	4,674
All Other Loans (including overdrafts)	-	-	-	-	-	-	-
Totals	$ 10,258	$ 11,810	$ 11,971	$ 12,691	$ 74,583	$ 5,204	$ 126,517

(in thousands)	Due Within 3 months or less	Due Over 3 mos through 12 months	Due Over 12 mo through 3 yrs	Due Over 3 yrs through 5 yrs	Due Over 5 yrs through 15 yrs	Due Over 15 yrs	Total
Variable Rate Loans							
Commercial, Financial and Agricultural	$ 52,780	$ 1,580	$ 9,757	$ 4,609	$ -	$ -	$ 68,726
Real Estate- Construction	79,292	-	3,049	-	-	-	82,341
Commercial Real Estate	34,189	17,805	60,934	40,906	1,345	-	155,179
Home Equity Lines of Credit	10,792	-	-	-	-	-	10,792
Installment Loans to Individuals	913	11	-	-	-	-	924
All Other Loans (including overdrafts)	504	-	-	-	-	-	504
Totals	$ 178,470	$ 19,396	$ 73,740	$ 45,515	$ 1,345	$ -	$ 318,466
Totals All Loans	$ 188,728	$ 31,206	$ 85,711	$ 58,206	$ 75,928	$ 5,204	$ 444,983

The following table sets forth changes from 2005 to 2006 for the loan portfolio categories.

(in thousands)	2006	2005	$ Variance	% Variance
Commercial, Financial and Agricultural	$ 84,976	$ 60,050	$ 24,926	41.51%
Real Estate- Construction	105,712	76,981	28,731	37.32%
Commercial Real Estate	237,401	210,690	26,711	12.68%
HELOC	10,792	14,398	(3,606)	-25.05%
Installment Loans to Individuals	5,598	5,620	(22)	-0.39%
All Other Loans (including overdrafts)	504	394	110	27.92%
Total Loans, Gross	444,983	368,133	76,850	20.88%
Deferred Loan Fees	(1,625)	(1,617)	(8)	0.49%
Reserve for Possible Loan Losses	(4,081)	(3,881)	(200)	5.15%
Total Loans, Net	$ 439,277	$ 362,635	$ 76,642	21.13%
Loans Held For Sale	$ 1,764	$ 3,392	$ (1,628)	-48.00%

The increase in commercial, financial and agricultural loans is attributed primarily to a $2.7 million new line of credit to a winery, a $5 million line of credit to a financial services company, an $8 million line of credit to a title company (collateralized by securities), a $1.9 million agricultural property loan, $3.4 million to acquire 3 restaurants and numerous other new $.5 to $1.0 million business lines of credit to medical groups, contractors and others.

The increase in real estate-construction loans can be attributed to several large new construction projects and the funding of existing construction projects. New loans include: a residential tract development for $4.7 million, a strip center for $4.0 million, a medical office complex for $6.7 million, an office complex for $1.7 million, increases in hotel loans to several clients for $2.9 million and $1.2 million, a $1.7 million mixed use property, an office building for $1.2 million, a $1.2 million hotel site land loan, a spec residence for $1.6 million, an apartment construction loan increase of $1.8 million, a meat processing facility for $1.2 million, a 4 home tract development for $2.2 million, a spec residence for $1.2 million, 4 loans on land for tract development of $2.4, $1.3, $1.2 and $1.2 million, and numerous other smaller projects. Construction loans are typically granted for a one year period and then, with income properties, are amortized over not more than 30 years with 10 to 15 year maturities.

The increase in commercial real estate loans is attributed to several of the construction loans moving into amortizing loans and to new commercial property loans. During the period, numerous loans were also refinanced and paid off through out of area lenders and mortgage brokers. New loans include a hotel for $5.4 million, a theatre complex for $7.3 million, restaurant properties for $2.6 million, a medical office for $1.3 million, a gas station for $2.0 million, an auto dealership for $1.2 million, a RV park for $1.2 million, an office building for $1.0 million, a medical office for $1.0 million and several smaller real estate loans.

The Bank presently has a concentration of loans in construction/land in the amount of $105.7 million which represents 204% of the Company's Tier I Capital. Of this, 60% are owner occupied thus the concentration is 144% net of owner occupied. Un-disbursed commitments total $41.8 million which combined with disbursed represent 284.6% of the Bank's Tier I Capital with 81% owner occupied. At December 31, 2006 there were 87 construction loans with outstanding balances and remaining commitments of approximately $81.6 million and $38.4 million, respectively. The single largest construction loan has an original commitment amount of approximately $12.6 million with a balance of approximately $6.3 million at December 31, 2006. The loan, an office complex in San Luis Obispo, Ca, has since paid down by $5.2 million. At December 31, 2006, there were 54 land loans with balances of approximately $24.1 million. The single largest land loan has a balance of approximately $1.7 million and is for a residential development. While these loans may be considered somewhat riskier than certain other real estate loans, the construction/land loans are spread throughout our market area and have consistently performed in a satisfactory manner.

Single family residence construction loans represent 19.07% of the total construction and land loan commitments. Land loans account for 19.33%, tract for 0.12%, multiple family income properties for 9.68%, owner occupied commercial properties for 28.62% and non-owner occupied commercial properties for 23.18%.

Hotel loans disbursed are not considered to be a concentration with balances of $46.4 million which represents 91.1% of the Bank's Tier I Capital. There are several hotel construction loans that increase total commitments to $68.6 million which represents a concentration at 132% of the Bank's Tier I Capital. At December 31, 2006, there were 35 motel loans. The single largest loan is a construction loan for $9.2 million with $4.7 million disbursed, for luxury suite/spa facility located in Paso Robles, Ca. The hotel loans are also made to clients throughout our market. These loans have also typically paid as agreed.

In September 2004, the Bank issued an $11.7 million irrevocable standby letter of credit to guarantee the payment of Taxable Variable Rate Demand Bonds. The primary purpose of the bond issue was to refinance existing debt and provide funds for capital improvements and expansion of an assisted living facility in San Luis Obispo. The project is approximately 100% complete with lease up in process. The letter of credit will expire in September 2007.

Construction loan demand for both single family and commercial real estate moderated during the first quarter of 2006 and then increased during the balance of the year. Increased interest rates and construction costs impacted commercial real estate activity. Home sales have slowed with builders now offering additional buyer incentives and lower prices. However, the area still remains desirable with prices considerably lower than the major metropolitan areas to the Company's North and South. Reasonable mortgage rates and financing options such as interest only mortgages and 40 year loans have kept many in the market. Because the bulk of the Company's loan portfolio is concentrated in commercial loans, we currently do not anticipate the potential slowing of the housing market in the coming year to have a major impact on our business. The continued availability of land for subdivision use also continued to drive the market in the North San Luis Obispo and Santa Maria markets. Builders are moving to more rural communities within our market area in order to construct more affordable homes.

Business properties are also in demand with low vacancies and competitive loan rates. Commercial property values and rental rates have increased during the year. Investors, many seeking exchange properties, continue to seek properties in our market area. Capitalization rates have steadily decreased with increased demand. Capitalization rate (the rate at which a stream of future cash flows is discounted to find their present value) ranges over the last three years are: 6.5% to 7.5% in 2004, 5.5% to 6.5% in 2005, and 5.0% to 6.5% in 2006. Low capitalization rate properties typically require larger down payments in order to satisfy bank debt coverage requirements. The Bank expects to experience continued growth in commercial real estate loans during 2007. Interest rate margins are expected to decrease somewhat due to competitive pressures and increasing cost of funds.

Loans held for sale consist of mortgage originations that have already been sold pursuant to correspondent mortgage loan agreements. There is no interest rate risk associated with these loans as the commitments are in place at the time that the Bank funds them. Settlement from the correspondents is typically within 30 to 45 days.

At December 31, 2006, the Bank had no foreign loans outstanding. The Bank did not have any concentrations of loans except as disclosed above.

The Bank's management is responsible for monitoring loan performance, which is done through various methods, including a review of loan delinquencies and personal knowledge of customers. Additionally, the Bank maintains both a "watch" list of loans that, for a variety of reasons, management believes requires regular review as well as an internal loan classification process. Annually, the loan portfolio is also reviewed by an experienced, outside loan reviewer not affiliated with the Bank. A list of delinquencies, the watch list, loan grades and the outside loan review are reviewed regularly by the Bank's Board of Directors.

The Bank has a non-accrual policy that requires a loan greater than 90 days past due to be placed on non-accrual status unless such loan is well-collateralized and in the process of collection. When loans are placed on non-accrual status, all uncollected interest accrued is reversed from earnings. Once on non-accrual status, interest on a loan is only recognized on a cash basis. Loans may be returned to accrual status if management believes that all remaining principal and interest is fully collectible and there has been at least six months of sustained repayment performance since the loan was placed on non-accrual. At December 31, 2006 non-accrual loans were $55 thousand.

If a loan's credit quality deteriorates to the point that collection of principal is believed by management to be doubtful and the value of collateral securing the obligation is sufficient the Bank generally takes steps to protect and liquidate the collateral. Any loss resulting from the difference between the loan balance and the fair market value of the property is recognized by a charge to the reserve for loan losses. When the property is held for sale after foreclosure, it is subject to a periodic appraisal. If the appraisal indicates that the property will sell for less than its recorded value, the Bank recognizes the loss by a charge to non-interest expense.

In mid 2006, a line of credit to a contractor went into default with the business liquidated and a resultant $500,000 charge off was incurred. A small residual balance remains with payment expected during 2007. Recovery of any significant portion of the charged off amount is not expected.

Total Cash and Due from Banks

Total cash and due from banks were $19.2 million, $18.3 million and $13.1 million at December 31, 2006, 2005 and 2004, respectively. This line item will vary depending on cash letters from the previous night and actual cash on hand in the branches. In December 2004, the Bank implemented a deposit re-classification program that enabled the Bank to reduce reserve requirements with the FRB by approximately $15 million.

Other earning assets are comprised of Federal Home Loan Bank stock, Federal Funds sold (funds lent on a short-term basis to other banks), investments in securities and short-term interest bearing deposits at other financial institutions. These assets are maintained for liquidity needs of the Bank, collateralization of public deposits, and diversification of the earning asset mix.

COMPOSITION OF OTHER EARNING ASSETS

(in thousands)

	2006		2005		2004	
	Amount	Percent	Amount	Percent	Amount	Percent
Federal Home Loan Bank, FRB and other stock	$ 2,350	5%	$ 1,885	3%	$ 1,809	3%
Available-for-Sale Investments	38,445	85%	44,402	61%	57,394	84%
Federal Funds Sold	3,870	9%	26,280	36%	5,775	8%
Interest Bearing Deposits other finanical institutions	318	1%	298	0%	3,498	5%
Total Other Earning Assets	$ 44,983	100%	$ 72,865	100%	$ 68,476	100%

The Company manages its securities portfolio to provide a source of both liquidity and earnings. The Bank has an asset/liability committee that develops current investment policies based upon its operating needs and market circumstance. The Bank's investment policy is formally reviewed and approved annually by the board of directors. The asset/liability committee of the Bank is responsible for reporting and monitoring compliance with the investment policy. Reports are provided to Bank's board of directors on a regular basis.

Securities available-for-sale are carried at fair value, with related unrealized net gains or losses, net of deferred income taxes, recorded as an adjustment to equity capital. As of December 31, 2006, there were net unrealized gains in the portfolio of $80 thousand compared to net unrealized losses of $158 thousand at December 31, 2005. During 2006 the portfolio decreased in size due primarily to prepayments on mortgage-backed securities. The fair value increased due generally to the effect of the inverted yield curve that created relatively stagnant long term interest rates in 2006. During 2005, the portfolio decreased in fair value due to a rising rate environment for long term investments.

All fixed and adjustable rate mortgage pools contain a certain amount of risk related to the uncertainty of prepayments of the underlying mortgages. Interest rate changes have a direct impact upon prepayment rates. The Bank uses computer simulation models to test the average life, duration, market volatility and yield volatility of adjustable rate mortgage pools under various interest rate assumptions to monitor volatility. Stress tests are performed quarterly.

The amortized cost and fair values of investment securities available for sale at December, 2006:

December 31, 2006 (in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Obligations of U.S. government agencies and corporations	$ 205	$ -	$ (4)	$ 201
Mortgage-backed securities	21,969	16	(381)	21,604
Obligations of State and Political Subdivisions	16,139	540	(38)	16,641
Other Securities	9	-	-	9
Total	$ 38,322	$ 556	$ (423)	$ 38,455

December 31, 2005 (in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Obligations of U.S. government agencies and corporations	$ 826	$ -	$ (20)	$ 806
Mortgage-backed securities	28,795	13	(518)	28,290
Obligations of State and Political Subdivisions	15,036	364	(103)	15,297
Other Securities	9	-	-	9
Total	$ 44,666	$ 377	$ (641)	$ 44,402

The Amortized cost, fair value, and maturites at December 31, 2006 are as follows:
(in thousands)

	Securities Available-for-Sale		
	Amortized Cost	Fair Value	Weighted Average Yield
Due in One Year or Less	$ 517	$ 515	1.93%
Due after One Year through Five Years	2,747	2,786	4.35%
Due after Five Years through TenYears	6,809	7,000	4.47%
Due after TenYears	6,280	6,550	4.64%
Mortgage-backed Securities	21,969	21,604	4.31%
Total	$ 38,322	$ 38,455	4.36%

Deposits and Borrowed Funds

The following table sets forth information for the last three fiscal years regarding the composition of deposits at December 31, and the average rates paid on each of these categories:

COMPOSITION OF DEPOSITS

(in thousands)

	2006		**2005**		**2004**	
	Balance	**Average Rate Paid**	**Balance**	**Average Rate Paid**	**Balance**	**Average Rate Paid**
Non-Interest Bearing Demand	$ 153,005	0.00%	$ 164,014	0.00%	$ 143,455	0.00%
Interest Bearing Demand	45,164	0.17%	50,598	0.16%	60,256	0.05%
Savings	23,406	0.40%	29,386	0.30%	36,232	0.25%
Money Market	77,540	2.70%	90,122	0.91%	69,527	0.95%
Time Deposits	121,406	4.21%	83,677	2.74%	60,971	1.54%
Total Deposits	$ 420,521	1.68%	$ 417,797	0.87%	$ 370,441	0.48%

Set forth is a maturity schedule of domestic time certificates of deposit of $100,000 and over at December 31, 2006:

TIME DEPOSITS $100,000 AND OVER:
(dollars in thousands)

Less than 3 months	$ 22,913
3 to 12 months	6,818
Over 1 year	899
Total	$ 30,630

The following table sets forth changes from 2006 to 2005 for deposit categories.

	2006	2005	$ Variance	% Variance
Non-Interest Bearing Demand	$ 153,005	$ 164,014	$ (11,009)	-6.71%
Interest Bearing Demand	45,164	50,598	(5,434)	-10.74%
	-			
Savings	23,406	29,386	(5,980)	-20.35%
	-			
Money Market	77,540	90,122	(12,582)	-13.96%
	-			
Time Deposits	121,406	83,677	37,729	45.09%
Total Deposits	$ 420,521	$ 417,797	$ 2,724	0.65%

The Company has experienced a shift in deposit categories throughout 2006 as lower cost funds migrated either internally to higher yielding products (time deposits) or to external competitive products. It is common knowledge throughout the local financial community that there is a fierce battle for deposit maintenance and gathering. One of the most notable initiatives during 2006 was the assessment of our deposit products and the delivery channels of same. The entire experience, along with assessment, enhancement and change in many delivery channels are the cornerstone to increasing core deposits in 2007.

Non-interest bearing demand deposits were 36.4% of total deposits at December 31, 2006 and decreased by approximately $11.0 million or 7% during 2006. The Bank has three large deposit relationships that it considers to be volatile. These deposits are held by long time customers of the Bank that engage in mortgage related activities. During 2006, the balances carried by these relationships decreased by approximately $8 million at December 31, 2006 compared to December 31, 2005. The decrease in mortgage related activity during 2006 had a direct impact on the deposit balances held by these entities. These volatile account relationships are included in the volatile liability dependency report that the Bank produces on a monthly basis. Management and the Board of Directors of the Bank are aware that as mortgage market conditions change, these relationships are impacted.

Savings, NOW and money market deposits were $146.1 million at December 31, 2006 compared to $170.1 million at December 31, 2005. This represents a decrease of approximately $24.0 million or 14%.

During 2006, time deposits increased by $37.7 million primarily as a result of increasing offering rates related to promotional activities at the Bank. Management also believes that depositors have become more sensitive to interest rate differentials between various deposit products as interest rates have risen since mid-2004. As depositors have become more rate sensitive the Bank has had to raise some offering rates to attract and retain deposits.

During 2005, time deposits increased by $22.7 million. This increase was a factor of a rising interest rate environment that started in 2004 and continued throughout 2005.

Core deposits (time deposits less than $100,000, demand, and savings) gathered in the local communities served by the Company continue to be the primary source of funds for loans and investments. Core deposits of $389.9 million represented 92.7% of total deposits at December 31, 2006 as compared to $400.4 million or 95.8% of total deposits at December 31, 2005. While the Company has a policy in place that permits Brokered Funds, at December 31, 2006, no action has been taken to include these on the balance sheet.

In October 2005 the Company renewed a promissory note with Pacific Coast Bankers Bank (PCBB) for a revolving line of credit in the amount of $3.5 million. The note is revolving in nature for the first two years and the terms of the note call for quarterly interest only payments for the first two years with subsequent principal and interest payments for eight years on a fully amortized basis. At December 31, 2006, the Company had a zero balance outstanding on this loan. The Company pledged 646,598 shares (51%) of the Bank's stock as collateral for the loan. At December 31, 2006, the interest rate on the note was 8.25% and is variable and moves with prime. Under the terms of the agreement, the Company will not incur any additional debt over $2 million exclusive of inter-company debt and existing debt without the prior written consent of PCBB. In addition, the Bank must be "well" capitalized on an on-going basis as defined by bank Regulators. The note was renewed as an additional financing option for the Company. The original 2 year note was executed In October 2003 and was originally obtained to assist with the cash and capital needs for the acquisition of Hacienda.

The Bank has established borrowing lines with the Federal Home Loan Bank (FHLB). At December 31, 2006, the Bank had borrowings with the FHLB of $50 million that are collateralized by loans. The average rate paid on FHLB borrowings for 2006 was 5.25%. In addition, the Bank has an $11.7 million letter of credit secured by loans. At December 31, 2006, the Bank, under the FHLB programs, has a remaining borrowing capacity with existing collateral of approximately $53.3 million and $9.1 million secured by loans and securities, respectively. The Bank utilizes securities sold under repurchase agreements as a source of funds. The Bank had $1.4 million in securities sold under repurchase agreements at December 31, 2006 compared to $3.8 million and $766 thousand at December 31, 2005 and 2004 respectively.

Capital

The Company's total stockholders equity was $49.2 million at December 31, 2006 compared to $44.8 million and $37.3 million at December 31, 2005 and 2004 respectively. The change in capital during 2006 was due to net income of $6.7 million, total cash dividends paid of $2.6 million, stock options exercised of $712 thousand, stock repurchased of $720 thousand, additional paid in capital of $336 thousand and an increase in accumulated other comprehensive income of $238 thousand.

On April 10, 2002, the Company issued $8,248,000 of Floating Rate Junior Subordinated Deferrable Interest Debentures (the "debt securities") to Heritage Oaks Capital Trust I, a statutory trust created under the laws of the

State of Delaware. These debt securities are subordinated to effectively all borrowings of the Company and are due and payable on April 22, 2032. Interest is payable quarterly on these debt securities at 6-Month LIBOR plus 3.7% for an effective rate of 9.09% as of December 31, 2006. The debt securities can be called at any time commencing on April 22, 2007, at par. The debt securities can also be redeemed at par if certain events occur that impact the tax treatment, regulatory treatment or the capital treatment of the issuance. The Company also purchased a 3% minority interest totaling $248,000 in Heritage Oaks Capital Trust I. The balance of the equity of Heritage Oaks Capital Trust I is comprised of mandatory redeemable preferred securities and is included in other assets. The Company anticipates that this issuance will be called on April 22, 2007 and the funds from the October issuance described in the next paragraph will be used to satisfy the called obligations.

On October 27, 2006, the Company issued $8,248,000 of Floating Rate Junior Subordinated Deferrable Interest Debentures (the “debt securities”) to Heritage Oaks Capital Trust II, a statutory trust created under the laws of the State of Delaware. These debt securities are subordinated to effectively all borrowings of the Company and are due and payable on October 27, 2036. Interest is payable quarterly on these debt securities at 3-Month LIBOR plus 1.71% for an effective rate of 7.10% as of December 31, 2006. The debt securities can be called at any time commencing on October 27, 2011, at par. The debt securities can also be redeemed at par if certain events occur that impact the tax treatment or the capital treatment of the issuance. The Company also purchased a 3% minority interest totaling $248,000 in Heritage Oaks Capital Trust II. The balance of the equity of Heritage Oaks Capital Trust II is comprised of mandatory redeemable preferred securities and is included in other assets.

Under FASB Interpretation (FIN) No. 46, “Consolidation of Variable Interest Entities, an interpretation of ARB No. 51,” the Company is not allowed to consolidate Heritage Oaks Capital Trust I and II into the Company’s financial statements. Prior to the issuance of FIN No. 46, Bank holding companies typically consolidated these entities. On February 28, 2005, the Federal Reserve Board issued a new rule which provides that, notwithstanding the deconsolidation of such trusts, junior subordinated debentures, such as those issued by the Company, may continue to constitute up to 25% of a bank holding company's Tier 1 capital, subject to certain new limitations which will not become effective until March 31, 2009 and which, in any event, are not expected to affect the treatment of the Company's Junior Subordinated Debentures as Tier 1 capital for regulatory purposes. As of December 31, 2006, the Company has included $14.35 million of the net junior subordinated debt in its Tier1 Capital for regulatory capital purposes.”

If the Company elects to defer interest payments pursuant to terms of the agreement, then the Company may not (i) declare or pay any dividends or distributions on, or redeem, purchase, acquire or make a liquidation payment with respect to any of the Company’s capital stock, or (ii) make any payment of principal of or premium, if any, or interest on or repay, repurchase or redeem any debt securities of the Company that rank pari passu with or junior in interest to the Debt Securities, other than, among other items, a dividend in the form of stock, warrants, options or other rights in the same stock as that on which the dividend is being paid or ranks pari passu with or junior to such stock. The prohibition on payment of dividends and payments on pari passu or junior debt also applies in the case of an event of default under the agreements.

At December 31, 2006, the Company had sufficient cash to service the $16.4 million in junior subordinated debenture interest payments for approximately six years without dividends from subsidiaries. The Bank’s capacity to provide cash to the Company, while remaining “well-capitalized”, was approximately $6 million at December 31, 2006.

Capital ratios for commercial banks in the United States are generally calculated using three different formulas. These calculations are referred to as the "Leverage Ratio" and two "risk based" calculations known as: "Tier One Risk Based Capital Ratio" and the "Total Risk Based Capital Ratio." These standards were developed through joint efforts of banking authorities from 12 different countries around the world. The standards essentially take into account the fact that different types of assets have different levels of risk associated with them. Furthermore, they take into account the off-balance sheet exposures of banks when assessing capital adequacy.

The Leverage Ratio calculation simply divides common stockholders’ equity (reduced by any goodwill a bank may have) by the total assets of the Bank. In the Tier One Risk Based Capital Ratio, the numerator is the same as the leverage ratio, but the denominator is the total "risk-weighted assets" of the Bank. Risk weighted assets are determined by segregating all the assets and off balance sheet exposures into different risk categories and weighting them by a percentage ranging from 0% (lowest risk) to 100% (highest risk). The Total Risk Based Capital Ratio again uses "risk-weighted assets" in the denominator, but expands the numerator to include other capital items besides equity such as a limited amount of the loan loss reserve, long-term capital debt, preferred stock and other instruments.

Summarized below are the Company's and the Bank's capital ratios at December 31, 2006.

	Minimum Regulatory Capital Requirements	Heritage Oaks Bancorp	Heritage Oaks Bank
Leverage Ratio	4.00%	11.00%	9.89%
Tier I Risk Weighted	4.00%	11.51%	10.37%
Total Risk Based	8.00%	12.36%	11.21%

For the Company, approximately $14.4 million of the $16 million of the trust preferred securities are accounted for as Tier I Capital, with the remaining $1.6 million accounted for as Tier II for purposes of calculating Regulatory Capital.

Liquidity

The objective of liquidity management is to ensure the continuous availability of funds to meet the demands of depositors, investors and borrowers. Asset liquidity is primarily derived from loan payments and the maturity of other earning assets. Liquidity from liabilities is obtained primarily from the receipt of new deposits. The Bank's Asset Liability Committee (ALCO) is responsible for managing the on-and off-balance sheet commitments to meet the needs of customers while achieving the Bank's financial objectives. ALCO meets regularly to assess the projected funding requirements by reviewing historical funding patterns, current and forecasted economic conditions and individual customer funding needs. Deposits generated from the Bank's customers serve as the primary source of liquidity. The Bank has credit arrangements with correspondent banks that serve as a secondary liquidity source. At December 31, 2006, these credit lines totaled $13.4 million and the Bank had no borrowings against those lines. The Bank is a member of the FHLB and has collateralized borrowing capacities remaining of $62.4 million at December 31, 2006.

The Bank manages liquidity by maintaining a majority of the investment portfolio in federal funds sold and other liquid investments. At December 31, 2006, the ratio of liquid assets not pledged for collateral and other purposes to deposits and other liabilities was 9.31% compared to 16.05% in 2005. The ratio of net loans to deposits (LTD), another key liquidity ratio, was 104.5% at December 31, 2006 compared to 86.8% at December 31, 2005 both of which remain within the Bank's policy guidelines. While the Bank still provides the majority of loan funding with core deposits, due to the highly competitive nature of deposit gathering the Bank has found it necessary to rely on borrowed funds. With the banking industry's common use of alternative funding sources, i.e. FHLB borrowing, in 2006 the Bank implemented a tracking ratio of Loan-to-Funding (LTF). This ratio is calculated by dividing gross loans by the sum of total deposits and alternative funding sources both available and used. At December 31, 2006, the LTF ratio was 84.03%. The Bank's key focus remains to increase core deposits and minimize alternative funding sources.

Inflation

The assets and liabilities of a financial institution are primarily monetary in nature. As such they represent obligations to pay or receive fixed and determinable amounts of money that are not affected by future changes in prices. Generally, the impact of inflation on a financial institution is reflected by fluctuations in interest rates, the ability of customers to repay debt and upward pressure on operating expenses. The effect on inflation during the three-year period ended December 31, 2006 has been significant to the Company's financial position or results of operations in regard to fluctuation in interest rates creating changing net interest margins. Inflation has not been a factor in customers' ability to repay debt but has been a factor in upward pressure on operation expenses.

Critical Accounting Policies and Estimates

Our accounting policies are integral to understanding the results reported. Accounting policies are described in detail in Note 1 of the NOTES TO CONSOLIDATED FINANCIAL STATEMENTS. Our most complex accounting policies require management's judgment to ascertain the valuation of assets, liabilities, commitments and contingencies. We have established detailed policies and control procedures that are intended to ensure valuation methods are well controlled and applied consistently from period to period. In addition, the policies and procedures are intended to ensure that the process for changing methodologies occurs in an appropriate manner.

The following is a brief description of our current accounting policies involving significant management valuation judgments.

Allowance for Loan and Lease Losses
The allowance for loan and lease losses represents management's best estimate of losses inherent in the existing loan portfolio. The allowance for loan and lease losses is increased by the provision for loan and lease losses charged to expense and reduced by loans charged-off, net of recoveries. The allowance for loan and lease losses is determined based on management's assessment of several factors: reviews and evaluation of individual loans, changes in the nature and volume of the loan portfolio, current economic conditions and the related impact on specific borrowers and industry groups, historical loan loss experiences and the level of classified and nonperforming loans.

Loans are considered impaired if, based on current information and events, it is probable that we will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. The measurement of impaired loans is generally based on the present value of expected future cash flows discounted at the historical effective interest rate stipulated in the loan agreement, except that all collateral-dependent loans are measured for impairment based on the fair value of the collateral. In measuring the fair value of the collateral, management uses assumptions and methodologies consistent with those that would be utilized by unrelated third parties.

Changes in the financial condition of individual borrowers, economic conditions, historical loss experience and the condition of the various markets in which collateral may be sold may all affect the required level of the allowance for loan and lease losses and the associated provision for loan and lease losses.

Securities Available for Sale
The fair value of most securities that are designated available for sale are based on quoted market prices. If quoted market prices are not available, fair values are extrapolated from the quoted prices of similar instruments.

Goodwill and Other Intangible Assets
As discussed in Note 6 of the NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, we assess goodwill and other intangible assets each year for impairment. This assessment involves estimating cash flows for future periods. If the future cash flows were materially less than the recorded goodwill and other intangible assets balances, we would be required to take a charge against earnings to write down the assets to the lower value. The Company's assessment at December 31, 2006 pursuant to its Goodwill Impairment Testing Policy resulted in no impairment.

Deferred Tax Assets
We use an estimate of future earnings to support our position that the benefit of our deferred tax assets will be realized. If future income should prove nonexistent or less than the amount of the deferred tax assets within the tax years to which they may be applied, the asset may not be realized and our net income will be reduced. Our deferred tax assets are described further in Note 9 of the NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

Supplemental Employee Compensation Benefits Agreements

As described in Note 12 of the NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, we have entered into supplemental employee compensation benefits agreements with certain executive and senior officers. The measurement of the liability under these agreements includes estimates involving life expectancy, length of time before retirement, and expected benefit levels. Should these estimates prove materially wrong, we could incur additional or reduced expense to provide the benefits.

Recent Accounting Developments

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109* (FIN 48) which clarifies the accounting and disclosure for uncertainty in tax positions, as defined. FIN 48 seeks to reduce the diversity in practice associated with certain aspects of the recognition and measurement related to accounting for income taxes. This interpretation is effective for fiscal years beginning after December 15, 2006. The Company is in the process of determining the impact this interpretation will have on our results from operations or financial position.

Effective January 1, 2006, we adopted the fair value recognition provisions of statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), "Share-Based Payment" (SFAS No.123(R)), using the modified prospective transition method and, therefore, have not restated results for prior periods. Under this transition method, stock-based compensation expense for the nine months ending September 30, 2006 included compensation expense for all stock-based compensation awards granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provision of SFAS No. 123, "Accounting for Stock-Based Compensation" ("SFAS No.123"). Stock-based compensation expense for all stock-based compensation awards granted after January 1, 2006 is based on the grant-date fair value estimated in accordance with the provisions of SFAS No.123(R). The Company recognizes these compensation costs on a straight-line basis over the requisite service period of the award. Prior to the January 1, 2006 adoption of SFAS No.123(R), the Company recognized stock-based compensation expense in accordance with Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees" (APB No. 25). In March 2005, the Securities and Exchange Commission (the SEC) issued Staff Accounting Bulletin No. 107 (SAB No. 107) regarding the SEC's interpretation of SFAS No.123(R) and the valuation of share-based payments for public companies. The Company has applied the provisions of SAB No. 107 in its adoption of SFAS No. 123(R). See Note 1 to the audited Consolidated Financial Statements for a further discussion on stock-based compensation.

In February 2006, the FASB issued SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments - an amendment of FASB Statements No. 133 and 140." SFAS No. 155 simplifies accounting for certain hybrid instruments currently governed by SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," by allowing fair value re-measurement of hybrid instruments that contain an embedded derivative that otherwise would require bifurcation. SFAS No. 155 also eliminates the guidance in SFAS No.133 Implementation Issue No. D1, "Application of Statement 133 to Beneficial Interests in Securitized Financial Assets," which provides such beneficial interests are not subject to SFAS No.133. SFAS No. 155 amends SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities - a Replacement of FASB Statement No. 125," by eliminating the restriction on passive derivative instruments that a qualifying special-purpose entity may hold. This statement is effective for financial instruments acquired or issued after the beginning of the Company's fiscal year 2007. The Company does not expect the adoption of this statement to have a material impact on the Company's financial condition, results of operations or cash flows.

In March 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 156, "Accounting for Servicing of Financial Assets- an amendment of FASB Statement No. 140." SFAS No.156 requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract in specific situations. Additionally, the servicing asset or servicing liability shall be initially measured at fair value; however, an entity may elect the "amortization method" or "fair value method" for subsequent balance sheet reporting periods. SFAS No.156 is effective as of an entity's first fiscal year beginning after September 15, 2006. Early adoption is permitted as of the beginning of an entity's fiscal year, provided the entity has not yet issued financial statements, including interim financial statements, for any period of that fiscal year. The Company does not expect the adoption of this statement to have a material impact on its financial condition, results of operations or cash flows.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (FAS 157). FAS 157 enhances existing guidance for measuring assets and liabilities using fair value. Prior to the issuance of FAS 157, guidance for applying fair value was incorporated in several accounting pronouncements. FAS 157 provides a single definition of fair value, together with a framework for measuring it, and requires additional disclosure about the use of fair value to measure assets and liabilities. FAS 157 also emphasizes that fair value is a market-based measurement, not an entity-specific measurement, and sets out a fair value hierarchy with the highest priority being quoted prices in active markets. Under FAS 157, fair value measurements are disclosed by level within that hierarchy. While FAS 157 does not add any new fair value measurements, it does change current practice. Changes to practice include: (1) a requirement for an entity to include its own credit standing in the measurement of its liabilities; (2) a modification of the transaction price presumption; (3) a prohibition on the use of block discounts when valuing large blocks of securities for broker-dealers and investment companies; and (4) a requirement to adjust the value of restricted stock for the effect of the restriction even if the restriction lapses within one year. FAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company has not determined the impact of adopting FAS 157 on its financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans (an amendment of FASB Statements No. 87, 88, 106, and 132R)* (FAS 158), requires an employer to: (a) Recognize in its statement of financial position an asset for a plan's over funded status or a liability for a plan's under funded status; (b) measure a plan's assets and its obligations that determine its funded status as of the end of the employer's fiscal year (with limited exceptions); and (c) recognize changes in the funded status of a defined benefit postretirement plan in the year in which the changes occur. Those changes will be reported in comprehensive income of a business entity and in changes in net assets of a not-for-profit organization. The requirement by FAS 158 to recognize the funded status of a benefit plan and the disclosure requirements of FAS 158 are effective as of the end of the fiscal year ending after December 15, 2006 for entities with publicly traded equity securities. The requirement to measure plan assets and benefit obligations as of the date of the employer's fiscal year-end statement of financial position is effective for fiscal years ending after December 15, 2008. The Company does not expect the adoption of FAS 158 to have a material effect on the financial position of the company at December 31, 2006.

In February of 2007, the FASB Issued SFAS No. 159, *Establishing the Fair Value Option for Financial Assets and Liabilities.* The Financial Accounting Standards Board has issued SFAS 159 to permit all entities to choose to elect, at specified election dates, to measure eligible financial instruments at fair value. An entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date, and recognize upfront costs and fees related to those items in earnings as incurred and not deferred. SFAS No. 159 applies to fiscal years beginning after November 15, 2007, with early adoption permitted for an entity that has also elected to apply the provisions of SFAS No. 157, Fair Value Measurements. An entity is prohibited from retrospectively applying SFAS No. 159, unless it chooses early adoption. SFAS No. 159 also applies to eligible items existing at November 15, 2007 (or early adoption date). The Company does not expect the adoption of FAS 159 to have a material effect on the Company's financial condition.

This discussion should be read in conjunction with the consolidated financial statements of the Company, including the notes thereto, appearing elsewhere in this report.

Off-Balance sheet Arrangements, Contractual Obligations and Contingent Liabilities

In the ordinary course of business, the Company may enter into off-balance sheet financial instruments consisting of commitments to extend credit, commercial letters of credit, and standby letters of credit. Such financial instruments are recorded in the financial statement when they are funded or related fees are incurred or received.

(in thousands)	Less than one year	One to Three Years	Three to Five Years	More than Five Years	Total
Long Term Debt Obligations	$ -	$ -	$ -	$ 16,496	$ 16,496
Operating Lease Obligations	882	1,684	1,017	205	3,788
Totals	$ 882	$ 1,684	$ 1,017	$ 16,701	$ 20,284

As noted in Footnote 10 to the financial statements, the Company is contingently liable for letters of credit made to its customers in the ordinary course of business totaling $17.7 million at December 31, 2006, up from $17.0 million one year earlier. Additionally, the Company has un-disbursed loan commitments, also made in the ordinary course of business, totaling $166.5 million, which was down from the $167.7 million outstanding one year earlier. The Company has an allowance for losses-unfunded commitments totaling $163 thousand at December 31, 2006, to cover losses inherent in its letter of credit accommodations and un-disbursed loan commitments.

There are no Special Purpose Entity ("SPE") trusts, corporations, or other legal entities established by the Company which reside off-balance sheet. There are no other off-balance sheet items other than the aforementioned items related to letter of credit accommodations and un-disbursed loan commitments.

As noted in Footnote 15 to the financial statements, the Company does make loans to related parties (directors and officers) in the ordinary course of business at prevailing rates and terms. These loans totaled $15.5 million and $14.6 million at the end of 2006 and 2005, respectively.

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

As a financial institution, the Company's primary component of market risk is interest rate volatility. Fluctuations in interest rates will ultimately impact both the level of interest income and interest expense recorded on a large portion of the Company's assets and liabilities, and the market value of all interest earning assets and interest bearing liabilities, other than those which possess a short term to maturity. Virtually all of the Company's interest earning assets and interest bearing liabilities are located at the banking subsidiary level. Thus, virtually all of the

Company's interest rate risk exposure lies at the banking subsidiary level other than $16.4 million in subordinated debentures issued by the Company's subsidiary grantor trusts. As a result, all significant interest rate risk procedures are performed at the banking subsidiary level. The subsidiary bank's real estate loan portfolio, concentrated primarily within Northern Santa Barbara County and San Luis Obispo County, California, are subject to risks associated with the local economy.

The fundamental objective of the Company's management of its assets and liabilities is to maximize the Company's economic value while maintaining adequate liquidity and an exposure to interest rate risk deemed by Management to be acceptable. Management believes an acceptable degree of exposure to interest rate risk results from the management of assets and liabilities through maturities, pricing and mix to attempt to neutralize the potential impact of changes in market interest rates. The Company's profitability is dependent to a large extent upon its net interest income, which is the difference between its interest income on interest-earning assets, such as loans and investments, and its interest expense on interest-bearing liabilities, such as deposits and borrowings. The Company is subject to interest rate risk to the degree that its interest-earning assets re-price differently than its interest-bearing liabilities. The Company manages its mix of assets and liabilities with the goals of limiting its exposure to interest rate risk, ensuring adequate liquidity, and coordinating its sources and uses of funds.

The Company seeks to control interest rate risk exposure in a manner that will allow for adequate levels of earnings and capital over a range of possible interest rate environments. The Company has adopted formal policies and practices to monitor and manage interest rate risk exposure. Management believes historically it has effectively managed the effect of changes in interest rates on its operating results. Management believes that it can continue to manage the short-term effect of interest rate changes under various interest rate scenarios.

Management employs the use of an Asset and Liability Management software that is used to measure the Bank's exposure to future changes in interest rates. This model measures the expected cash flows and re-pricing of each financial asset/liability separately in measuring the Bank's interest sensitivity. Based on the results of this model, management believes the Bank's balance sheet is "asset sensitive". The Company generally expects expansion in its net interest income if rates rise and expects, conversely, contraction if rates fall. The level of potential or expected contraction indicated by the tables below is considered acceptable by management and is compliant with the Bank's ALCO policies. Management will continue to perform this analysis each quarter to further validate the expected results against actual data.

The hypothetical impacts of sudden interest rate movements applied to the Company's asset and liability balances are modeled monthly. The results of this movement indicate how much of the Company's net interest income is "at risk" from various rate changes over a one year horizon. This exercise is valuable in identifying risk exposures. The results for the Company's December 31, 2006 balances indicate that the net interest income at risk over a one year time horizon for a 1% and 2% rate increase and decrease are within the Company's policy guidelines for such changes.

December 31, 2006

(dollars in Thousands)	Shock Rate Scenarios				
	-200bp	-100bp	Base	+100bp	+200bp
Net Interest Income (NII)	$ 25,819	$ 26,788	$ 27,859	$ 28,766	$ 29,677
$ Change from Base	$ (2,040)	$ (1,070)	$ -	$ 907	$ 1,818
% Change from Base	-7.32%	-3.84%	0.00%	3.26%	6.53%

It is important to note that the above table is a summary of several forecasts and actual results may vary. The forecasts are based on estimates and assumptions of management that may turn out to be different and may change over time. Factors affecting these estimates and assumptions include, but are not limited to 1) competitor behavior, 2) economic conditions both locally and nationally, 3) actions taken by the Federal Reserve Board, 4) customer behavior and 5) management's responses. Changes that vary significantly from the assumptions and estimates may have significant effects on the Company's net interest income, therefore, the results of this analysis should not be relied upon as indicative of actual future results.

The following tables show Management's estimates of how the loan portfolio is broken out between variable-daily, variable at various time lines, fixed rate loans and estimates of re-pricing opportunities for the entire loan portfolio.

(dollars in Thousands)

Gross Loans	Balance	% of Total
Variable-Daily	$ 179,542	40%
Variable-Other than daily	198,509	45%
Fixed	66,933	15%
Total Gross Loans	$ 444,983	100%

Gross Loans Re-Pricing	Balance	% of Total
< 1 Year	$ 265,501	60%
1-3 Years	97,910	22%
3-5 Years	58,115	13%
> 5 Years	23,457	5%
	$ 444,983	100%

Non-performing Loans	$ 55
% Gross Loans	0.01%

The table above identifies approximately 40% of the loan portfolio that will re-price immediately in a changing rate environment.

The Company also attempts to quantify the impact of interest rate changes on borrowers' ability to pay on loans and the impact of similar rate changes on the value of collateral held against loans. To this end, the Company, from time to time, will sample loans and analyze them under a rate shock scenario to specifically assess the impact of the rate shock on financial ratios such as interest rate coverage and loan-to-value. The results of the analysis have generally revealed that in the case of such a rate shock, a high percentage of loans tested would continue to express ratios within current underwriting guidelines. The results of these analyses are considered acceptable by management.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

HERITAGE OAKS BANCORP AND SUBSIDIARIES

DECEMBER 31, 2006, 2005, AND 2004

Contents

Financial Statements

Report of Independent Registered Public Accounting Firm

Board of Directors
Heritage Oaks Bancorp
Paso Robles, California

We have audited the accompanying consolidated balance sheets of Heritage Oaks Bancorp and Subsidiaries (the "Company") as of December 31, 2006 and 2005, and the related consolidated statements of income, changes in stockholders' equity and cash flows for each of the three years in the period ended December 31, 2006. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Heritage Oaks Bancorp and Subsidiaries as of December 31, 2006 and 2005, and the results of its operations, changes in its stockholders' equity, and its cash flows for each of the three years in the period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Heritage Oaks Bancorp and Subsidiaries internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 1, 2007 expressed an unqualified opinion thereon.

/s/ Vavrinek, Trine, Day & Co., LLP
Rancho Cucamonga, California
March 1, 2007

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders
Heritage Oaks Bancorp and Subsidiary
Paso Robles, California

We have audited management's assessment, included in the accompanying Report of Management, that Heritage Oaks Bancorp and Subsidiary (the "Company") maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in conformity with U.S. generally accepted accounting principles.

A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles, and the receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that Heritage Oaks Bancorp and Subsidiary maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets as of December 31, 2006 and 2005, and the related consolidated statements of income, stockholders equity and cash flows for each of the three years in the period ended December 31, 2006 and our report dated March 1, 2007 expressed an unqualified opinion.

/s/ Vavrinek, Trine, Day & Co., LLP
Rancho Cucamonga, California
March 1, 2007

Management's Report on Internal Control Over Financial Reporting

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

As of December 31, 2006, management assessed the effectiveness of the Company's internal control over financial reporting based on the criteria for effective internal control over financial reporting established in *Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission* (COSO). Based on the assessment, management determined that the Company maintained effective internal control over financial reporting as of December 31, 2006, based on those criteria.

Vavrinek, Trine, Day & Co., LLP, the independent registered public accounting firm that audited the consolidated financial statements of the Company included in this Annual Report on Form 10-K, has issued an attestation report on management's assessment of the Company's internal control over financial reporting as of December 31, 2006. The report, which expresses unqualified opinions on management's assessment and on the effectiveness of the Company's internal control over financial reporting as of December 31, 2006, is included below under the heading "Report of Independent Registered Public Accounting Firm."

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

/s/ Lawrence P. Ward	/s/ Margaret A. Torres
Lawrence P. Ward	**Margaret A. Torres**
Chief Executive Officer	**Executive Vice President, Chief Financial Officer**

HERITAGE OAKS BANCORP AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2006 AND 2005
(Dollars in thousands, except per share amounts)

Assets

	2006	2005
Cash and due from banks	$ 19,164	$ 18,279
Federal funds sold	3,870	26,280
Total Cash and Cash Equivalents	23,034	44,559
Interest-bearing deposits in other financial institutions	318	298
Investment securities, available-for-sale	38,445	44,402
Federal Home Loan Bank and Federal Reserve Bank Stock, at cost	2,350	1,885
Loans held for sale	1,764	3,392
Loans, net of deferred fees of $1,625 and $1,617 and allowance for loan loss of $4,081 and $3,881 at December 31, 2006 and 2005, respectively	439,277	362,635
Property premises and equipment, net	14,581	11,905
Net deferred tax asset	2,414	2,358
Cash surrender value of life insurance	9,435	7,706
Goodwill	4,865	4,865
Intangible assets	1,148	1,448
Other assets	4,143	3,048
Total Assets	$ 541,774	$ 488,501

Liabilities and Stockholders' Equity

	2006	2005
Liabilities		
Deposits		
Demand non-interest bearing	$ 153,005	$ 164,014
Savings, NOW and money market deposits	146,110	170,106
Time deposits of $100 or more	30,630	17,414
Time deposits under $100	90,776	66,263
Total Deposits	420,521	417,797
FHLB advances and other borrowings	50,000	10,000
Securities sold under agreement to repurchase	1,364	3,847
Junior subordinated debentures	16,496	8,248
Other liabilities	3,921	3,764
Total Liabilities	492,302	443,656
COMMITMENTS AND CONTINGENCIES (Notes #5 and #10)	-	-
Stockholders' Equity		
Common stock, no par value; 20,000,000 shares authorized; 6,345,639 and 6,231,982 shares issued and outstanding for 2006 and 2005, respectively	29,247	29,255
Additional paid in capital	336	-
Retained earnings	19,809	15,748
Accumulated other comprehensive income/(loss), net of taxes of $96 in 2006 and $204 in 2005	80	(158)
Total Stockholders' Equity	49,472	44,845
Total Liabilities and Stockholders' Equity	$ 541,774	$ 488,501

HERITAGE OAKS BANCORP AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
FOR THE YEARS ENDED DECEMBER 31, 2006, 2005, AND 2004
(Dollars in thousands, except per share amounts)

	2006	2005	2004
Interest Income			
Interest and fees on loans	$ 33,897	$ 27,399	$ 20,615
Interest on Investment Securities			
Obligations of U.S. Government Agencies	1,083	1,389	1,767
Obligations of State and Political Subdivisions	702	593	506
Interest on time deposits with other banks	9	9	11
Interest on Federal funds sold	539	667	302
Interest on other securities	142	118	112
Total Interest Income	36,372	30,175	23,313
Interest Expense			
Interest on savings, NOW and money market deposits	2,497	1,695	699
Interest on time deposits in denominations of $100 or more	626	413	118
Interest on time deposits under $100	3,845	1,371	953
Other borrowings	2,348	1,537	1,591
Total Interest Expense	9,316	5,016	3,361
Net interest income before provision for possible loan losses	27,056	25,159	19,952
Provision for Possible Loan Losses	600	710	410
	26,456	24,449	19,542
Noninterest Income			
Fees and service charges	2,427	2,430	2,173
Investment securities gain/(loss), net	9	-	28
Gain on sale of SBA loans, net	19	84	45
Gain/(loss) on sale of premise, net	(38)	4	712
Other	2,535	2,491	2,041
Total Noninterest Income	4,952	5,009	4,999
Noninterest Expenses			
Salaries and employee benefits	11,573	9,746	8,457
Equipment expenses	868	824	929
Occupancy expenses	1,739	1,667	1,640
Other expenses	6,775	6,481	6,172
Total Noninterest Expenses	20,955	18,718	17,198
Income Before Provision for Income Taxes	10,453	10,740	7,343
Provision for Income Taxes	3,791	4,103	2,759
Net Income	$ 6,662	$ 6,637	$ 4,584
Earnings Per Share			
Basic	$ 1.05	$ 1.08	$ 0.77
Diluted	$ 1.01	$ 1.01	$ 0.71

HERITAGE OAKS BANCORP AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
FOR YEARS ENDED DECEMBER 31, 2006, 2005, AND 2004
(Dollars in thousands, except per share amounts)

	Common Stock		Additional			Accumulated Other	Total
	Number of Shares	Amount	Paid-In Capital	Comprehensive Income	Retained Earnings	Comprehensive Income/(loss)	Stockholders' Equity
Balance, January 1, 2004	3,604,497	$ 20,649	$ -		$ 11,541	$ 98	$ 32,288
Exercise of stock options (including $136 tax benefit from exercise of stock options)	33,625	335					335
Cash paid to stockholders in lieu of fractional shares on 5% stock dividend					(6)		(6)
5% stock dividend	179,821	3,066			(3,066)		-
Comprehensive income							
Net income				$ 4,584	4,584		4,584
Unrealized security holding gains (net of $44 tax)				66		66	66
Less reclassification adjustments for gains (net of $11 tax)				(17)		(17)	(17)
Total comprehensive income				$ 4,633			
Balance, December 31, 2004	3,817,943	24,050	-		13,053	147	37,250
Exercise of stock options (including $588 tax benefit from exercise of stock options)	144,674	1,275					1,275
Cash paid to stockholders in lieu of fractional shares on 5% stock dividend					(7)		(7)
5% stock dividend	195,013	3,930			(3,930)		-
3 for 2 stock split	2,074,352						
Cash paid to stockholders in lieu of fractional shares on 3 for 2 stock split					(5)		(5)
Comprehensive income							
Net income				$ 6,637	6,637		6,637
Unrealized security holding losses (net of $204 tax)				(305)		(305)	(305)
Total comprehensive income				$ 6,332			
Balance, December 31, 2005	6,231,982	29,255	-		15,748	(158)	44,845
Exercise of stock options (including $365 tax benefit from exercise of stock options)	87,607	712					712
Cash dividends paid in 2006					(2,601)		(2,601)
Share-based compensation expense		-	336				336
Issuance of Restricted Stock Awards	66,050						
Stock Repurchased	(40,000)	(720)					(720)
Comprehensive income							
Net income				$ 6,662	6,662		6,662
Unrealized security holding gains (net of $92 tax)				233		233	233
Less reclassification adjustments for gains (net of $4 tax)				5		5	5
Total comprehensive income				$ 6,900			
Balance, December 31, 2006	6,345,639	$ 29,247	$ 336		$ 19,809	$ 80	$ 49,472

HERITAGE OAKS BANCORP AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS DECEMBER 31, 2006, 2005, AND 2004
(Dollars in thousands, except per share amounts)

	2006	2005	2004
Cash Flows from Operating Activities			
Net income	$ 6,662	$ 6,637	$ 4,584
Adjustments to reconcile net income to net cash provided by operating activities			
Net cash provided by operating activities			
Depreciation and amortization	958	897	949
Provision for possible loan losses	600	710	410
Provision for possible losses on unfunded loan commitments	-	10	25
Realized gain on sales of available-for-sale securities, net	(9)	-	(28)
Amortization of premiums/discounts on investment securities, net	(17)	184	407
Amortization of core deposit intangibles	300	573	421
Share-based compensation expense	336	-	-
Gain/(loss) on sale of property, premises and equipment, net	38	(4)	(712)
Net change in loans held for sale	1,628	(1,139)	2,149
Net increase in cash surrender value of life insurance	(343)	(276)	(271)
FHLB Dividends received	(97)	(76)	(72)
Decrease/(Increase) in deferred tax asset	(220)	(236)	20
Decrease/(Increase) in other assets	(727)	(119)	183
Increase/(decrease) in other liabilities	158	672	269
Excess tax benefit from share-based payment arrangements	(365)	-	-
NET CASH PROVIDED BY OPERATING ACTIVITIES	8,902	7,833	8,334
Cash Flows From Investing Activities			
Purchase of securities available-for-sale	(1,190)	(2,588)	(3,012)
Purchase of mortgage-backed securities available-for-sale	-	-	(17,295)
Net redemption (purchase) of Federal Home Loan Bank and Federal Reserve Bank stock	-	-	222
Proceeds from sales of mortgage-backed securities	-	-	1,534
Proceeds from principal reductions and maturities of securities available-for-sale	500	1,350	1,315
Proceeds from principal reductions and maturities of mortgage-backed securities	7,071	13,537	14,723
Net change in interest-bearing deposits in other financial institutions	(20)	200	-
Purchase of FHLB stock	(368)	-	-
Purchase of life insurance policies	(1,386)	(300)	-
Recoveries on loans	161	25	3
Increase in loans, net	(77,403)	(28,406)	(61,326)
Proceeds from sale of property, premises and equipment	-	900	900
Purchase of property, premises and equipment, net	(3,672)	(3,059)	(1,646)
NET CASH USED IN INVESTING ACTIVITIES	(76,307)	(18,341)	(64,582)

HERITAGE OAKS BANCORP AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)
FOR THE YEARS DECEMBER 31, 2006, 2005, AND 2004
(Dollars in thousands, except per share amounts)

	2006	2005	2004
Cash Flows From Financing Activities			
Increase in deposits, net	$ 2,724	$ 47,356	$ 4,002
Net increase/(decrease) in FHLB borrowings	40,000	(18,500)	-
Net (decrease)/increase in notes payable	-	-	(3,500)
Proceeds from issuance of junior subordinated debentures	8,248	-	-
Net increase in securities sold under agreement to repurchase	(2,483)	3,081	306
Proceeds from exercise of stock options	347	1,275	199
Excess tax benefit from share-based payment arrangements	365	-	-
Cash paid for stock repurchase	(720)	-	-
Cash dividends paid	(2,601)	-	-
Cash paid in lieu of fractional shares	-	(12)	(6)
NET CASH PROVIDED BY FINANCING ACTIVITIES	45,880	33,200	1,001
Net Increase/(Decrease) in Cash and Cash Equivalents	(21,525)	22,692	(55,247)
Cash and Cash Equivalents, Beginning of year	44,559	21,867	77,114
Cash and Cash Equivalents, End of year	$ 23,034	$ 44,559	$ 21,867

	2006	2005	2004
Supplemental Disclosures of Cash Flow Information			
Interest paid	$ 8,976	$ 4,912	$ 3,453
Income taxes paid	$ 3,670	$ 3,825	$ 2,575
Supplemental Disclosures of Non-Cash Flow Information			
Change in other valuation allowance for investment securities	$ 163	$ (509)	$ 82
Tax benefit of stock options exercised	$ 365	$ 588	$ 136

Note #1 - Summary of Significant Accounting Policies

The accounting and reporting policies of Heritage Oaks Bancorp (the Company) and subsidiaries conform to accounting principles generally accepted in the United States of America and to general practices within the banking industry. A summary of the Company's significant accounting and reporting policies consistently applied in the preparation of the accompanying financial statements follows:

Principles of Consolidation

The consolidated financial statements include the Company and its wholly owned subsidiaries, Heritage Oaks Bank, (the “Bank”) and CCMS Systems, Inc. Inter-company balances and transactions have been eliminated.

Nature of Operations

The Company has been organized as a single operating segment. The Bank operates eleven branches within San Luis Obispo and Northern Santa Barbara counties. The Bank offers traditional banking products such as checking, savings and certificates of deposit, as well as mortgage loans and commercial and consumer loans to customers who are predominately small to medium-sized businesses and individuals.

Investment in Non-Consolidated Subsidiary

The Company accounts for its investments in its wholly owned special purpose entities, Heritage Oaks Capital Trust I (the “Trust I”) and Heritage Oaks Capital Trust II (the “Trust II”), using the equity method under which the subsidiary’s net earnings are recognized in the Company’s statements of income.

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses on loans and the valuation of real estate acquired in connection with foreclosures or in satisfaction of loans. In connection with the determination of the allowances for losses on loans and foreclosed real estate, management obtains independent appraisals for significant properties.

While management uses available information to recognize losses on loans and foreclosed real estate, future additions to the allowances may be necessary based on changes in local economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Company’s allowances for losses on loans and foreclosed real estate. Such agencies may require the Company to recognize additions to the allowances based on their judgments about information available to them at the time of their examination. Because of these factors, it is reasonably possible that the allowances for losses on loans and foreclosed real estate may change.

Note #1 - Summary of Significant Accounting Policies, Continued

Cash and Due From Banks

Banking regulations require that all banks maintain a percentage of their deposits as reserves in cash or on deposit with the Federal Reserve Bank. The Banks complied with the reserve requirements as of December 31, 2006.

The Company maintains amounts due from banks that exceed federally insured limits. The Company has not experienced any losses in such accounts.

Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash, due from banks, federal funds sold and money market funds. Generally, federal funds are sold for one-day periods.

Investment Securities

In accordance with Statement of Financial Accounting Standards (SFAS) No. 115, "*Accounting for Certain Investments in Debt and Equity Securities,*" which addresses the accounting for investments in equity securities that have readily determinable fair values and for investments in all debt securities, securities are classified in three categories and accounted for as follows: debt, equity, and mortgage-backed securities that the Company has the positive intent and ability to hold to maturity are classified as held-to-maturity and are measured at amortized cost; debt and equity securities bought and held principally for the purpose of selling in the near term are classified as trading securities and are measured at fair value, with unrealized gains and losses included in earnings; debt and equity securities not classified as either held-to-maturity or trading securities are deemed as available-for-sale and are measured at fair value, with unrealized gains and losses, net of applicable taxes, reported in a separate component of stockholders' equity. Gains or losses on sales of investment securities are determined on the specific identification method. Premiums and discounts are amortized or accreted using the interest method over the expected lives of the related securities.

Declines in the fair values of individual held-to-maturity and available-for-sale securities below their cost that are other than temporary result in write-downs of individual securities to their fair value. The related write-downs are included in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recover in fair value.

Loans and Interest on Loans

Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at their outstanding unpaid principal balances reduced by any charge-offs of specific valuation accounts and net of any deferred fees or costs on originated loans, or unamortized premiums or discounts on purchased loans.

Loan origination fees and certain direct origination costs are capitalized and recognized as an adjustment of the yield of the related loan.

Loans on which the accrual of interest has been discontinued are designated as non-accrual loans. The accrual of interest on loans is discontinued when principal or interest is past due 90 days based on contractual terms of the loan or when, in the opinion of management, there is reasonable doubt as to collectibility. When loans are placed on non-accrual status, all interest previously accrued but not collected is reversed against current period

Note #1 - Summary of Significant Accounting Policies, Continued

interest income. Interest income generally is not recognized on specific impaired loans unless the likelihood of further loss is remote. Interest payments received on such loans are applied as a reduction to the loan principal balance. Interest accruals are resumed on such loans only when they are brought current with respect to interest and principal and when, in the judgment of management, the loans are estimated to be fully collectible as to all principal and interest.

The Company considers a loan to be impaired when it is probable that the Company will be unable to collect all amounts due (principal and interest) according to the contractual terms of the loan agreement. Measurement of impairment is based on the expected future cash flows of an impaired loan which are to be discounted at the loan's effective interest rate, or measured by reference to an observable market value, if one exists, or the fair value of the collateral for a collateral-dependent loan. The Company selects the measurement method on a loan-by-loan basis except that collateral-dependent loans for which foreclosure is probable are measured at the fair value of the collateral. The Bank recognizes interest income on impaired loans based on its existing methods of recognizing interest income on non-accrual loans.

All loans are generally charged off at such time the loan is classified as a loss.

Loans Held for Sale

Loans held for sale are carried at the lower of aggregate cost or market value, which is determined by the specified value in the commitments. Net unrealized losses, if any, are recognized through a valuation allowance by charges to expense.

Allowance for Loan Losses

The allowance for loan losses is maintained at a level which, in management's judgment, is adequate to absorb credit losses inherent in the loan portfolio. The amount of the allowance is based on management's evaluation of the collectibility of the loan portfolio, including the nature of the portfolio, credit concentrations, trends in historical loss experience, specific impaired loans, and economic conditions. Allowances for impaired loans are generally determined based on collateral values or the present value of estimated cash flows. The allowance is increased by a provision for loan losses, which is charged to expense and reduced by charge-offs, net of recoveries. Changes in the allowance relating to impaired loans are charged or credited to the provision for loan losses. Because of uncertainties inherent in the estimation process, management's estimate of credit losses inherent in the loan portfolio and the related allowance may change.

Property, Premises and Equipment

Land is carried at cost. Premises and equipment are carried at cost less accumulated depreciation and amortization. Depreciation is computed using the straight-line method over the estimated useful lives, which ranges from three to ten years for furniture and fixtures and forty years for buildings. Leasehold improvements are amortized using the straight-line method over the estimated useful lives of the improvements or the remaining lease term, whichever is shorter. Expenditures for betterments or major repairs are capitalized and those for ordinary repairs and maintenance are charged to operations as incurred. Total depreciation expenses for the reporting periods ending December 31, 2006, 2005, and 2004 were approximately $958, $897, and $949, respectively.

Note #1 - Summary of Significant Accounting Policies, Continued

Goodwill and Intangible Assets

The Company has engaged in the acquisition of financial institutions and the assumption of deposits and purchase of assets from other financial institutions. The Company has paid premiums on these acquisitions, and such premiums are recorded as intangible assets, in the form of goodwill or core deposit intangible assets.

Goodwill represents the excess of the purchase price over the estimated fair value of the net assets acquired. In accordance with the provisions of Statement of Financial Accounting No. ("SFAS") 142, goodwill is not being amortized whereas identifiable intangible assets with finite lives are amortized over their useful lives. On an annual basis, the Company is required to test goodwill for impairment. The Company's assessment at December 31, 2006 pursuant to its Goodwill Impairment Testing Policy resulted in no impairment.

Core deposit intangibles represent the intangible value of depositor relationships resulting from deposit liabilities assumed in acquisitions. Core deposit intangibles are being amortized over six and ten years. Intangibles are evaluated periodically for impairment. Should such an assessment indicate that the undiscounted value of an intangible may be impaired, the net book value of the intangible would be written down to the net estimated recoverable value.

Income Taxes

Provisions for income taxes are based on amounts reported in the statements of income (after exclusion of non-taxable income such as interest on state and municipal securities) and include deferred taxes on temporary differences in the recognition of income and expense for tax and financial statement purposes. Deferred taxes are computed on the liability method as prescribed in SFAS No. 109, "Accounting for Income Taxes."

Advertising Costs

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

Disclosure about Fair Value of Financial Instruments

SFAS No. 107 specifies the disclosure of the estimated fair value of financial instruments. The Company's estimated fair value amounts have been determined by the Company using available market information and appropriate valuation methodologies.

However, considerable judgment is required to develop the estimates of fair value. Accordingly, the estimates are not necessarily indicative of the amounts the Company could have realized in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

Although management is not aware of any factors that would significantly affect the estimated fair value amounts, such amounts have not been comprehensively revalued for purposes of these financial statements since the balance sheet date and, therefore, current estimates of fair value may differ significantly from the amounts presented in the accompanying notes.

Note #1 - Summary of Significant Accounting Policies, Continued

Financial Instruments

In the ordinary course of business, the Company has entered into off-balance sheet financial instruments consisting of commitments to extend credit, commercial letters of credit, and standby letters of credit as described in Note #10. Such financial instruments are recorded in the financial statements when they are funded or related fees are incurred or received.

Comprehensive Income

In accordance with SFAS No. 130, "*Reporting Comprehensive Income*," the Company classifies items of other comprehensive income by their nature in the financial statements and displays the accumulated other comprehensive income separately from retained earnings in the equity section of the Balance Sheet. Changes in unrealized gain (loss) on available-for-sale securities net of income taxes is the only component of accumulated other comprehensive income for the Company.

Reclassifications

Certain amounts in the 2005 and 2004 financial statements have been reclassified to conform to the 2006 presentation.

Earnings Per Share (EPS)

Basic EPS excludes dilution and is computed by dividing income available to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity.

Change in Accounting Principle – Share-Based Compensation

Effective January 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards ("SFAS") No. 123R, *Share-Based Payments*, a revision to the previously issued guidance on accounting for stock options and other forms of equity-based compensation. SFAS No. 123R requires companies to recognize in the income statement the grant-date fair value of stock options and other equity-based forms of compensation issued to employees over the employees' requisite service period (generally the vesting period). Prior to January 1, 2006, we accounted for share-based compensation to employees under the intrinsic value method prescribed in Accounting Principles Board ("APB") Opinion No. 25, *Accounting for Stock Issued to Employees*. Under the intrinsic value method, compensation expense is recognized only to the extent an option's exercise price is less than the market value of the underlying stock on the date of grant. No share-based compensation expense was reflected in net income as all options are required by the plan to be granted with an exercise price equal to the estimated fair value of the underlying common stock on the date of grant. We also followed the disclosure requirements of SFAS No. 123, *Accounting for Stock-Based Compensation*, as amended by SFAS No. 148, *Accounting for Share-Based Compensation – Transition and Disclosure.* We adopted SFAS No. 123R under the *modified prospective* method which means that the unvested portion of previously granted awards and any awards that are granted or modified after the date of adoption will be measured and accounted for under the provisions of SFAS No. 123R. Accordingly, financial statement amounts for prior periods presented have not been restated to reflect the fair value method of recognizing compensation cost relating to stock options. The Company will continue to use straight-line recognition of expenses for awards with graded vesting.

Note #1 - Summary of Significant Accounting Policies, Continued

In March 2005, the Securities and Exchange Commission (the SEC) issued Staff Accounting Bulletin No. 107 (SAB No. 107) regarding the SEC's interpretation of SFAS No.123(R) and the valuation of share-based payments for public companies. The Company has applied the provisions of SAB No. 107 in its adoption of SFAS No. 123(R).

As a result of adopting SFAS No. 123R on January 1, 2006, the Company's results for the year ended December 31, 2006 reflected the following changes:

(in thousands, except per share data)		For the yeard ended December 31, 2006 Increase/(Decrease)
Salaries and employee benefits	$	116
Income before income taxes	$	(116)
Provision for income taxes		(46)
Net income	$	(70)
Basic earnings per share	$	(0.01)
Diluted earnings per share	$	(0.01)

Prior to January 1, 2006, had compensation cost for the Company's stock option plans been determined based on the fair value at the grant dates for awards under those plans consistent with the method of SFAS No. 123, the Company's net income and earnings per share would have been reduced to the pro forma amount indicated below:

		2005		2004
Net income:				
As reported	$	6,637	$	4,584
Stock-based compensation using the intrinsic value method		-		-
Stock-based compensation that would have been reported using the fair value method of SFAS 123		(89)		(64)
Pro forma net income	$	6,548	$	4,520
Basic earnings per share:				
As reported	$	1.08	$	0.77
Pro forma		1.06		0.76
Diluted earnings per share:				
As reported	$	1.01	$	0.71
Pro forma		1.00		0.70

Prior to the adoption of SFAS No. 123(R), the Company presented the tax benefit of stock option exercises as operating cash flows, upon the adoption of SFAS No. 123(R), tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options are classified as financing cash flows.

Note #1 - Summary of Significant Accounting Policies, Continued

Current Accounting Pronouncements

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109* (FIN 48) which clarifies the accounting and disclosure for uncertainty in tax positions, as defined. FIN 48 seeks to reduce the diversity in practice associated with certain aspects of the recognition and measurement related to accounting for income taxes. This interpretation is effective for fiscal years beginning after December 15, 2006. The Company is in the process of determining the impact that this interpretation may have on our results from operations or financial position.

ACCOUNTING FOR CERTAIN HYBRID FINANCIAL INSTRUMENTS: In February 2006, the FASB issued SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments - an amendment of FASB Statements No. 133 and 140." SFAS No. 155 simplifies accounting for certain hybrid instruments currently governed by SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," by allowing fair value re-measurement of hybrid instruments that contain an embedded derivative that otherwise would require bifurcation. SFAS No. 155 also eliminates the guidance in SFAS No.133 Implementation Issue No. D1, "Application of Statement 133 to Beneficial Interests in Securitized Financial Assets," which provides such beneficial interests are not subject to SFAS No.133. SFAS No. 155 amends SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities - a Replacement of FASB Statement No. 125," by eliminating the restriction on passive derivative instruments that a qualifying special-purpose entity may hold. This statement is effective for financial instruments acquired or issued after the beginning of the Company's fiscal year 2007. The Company does not expect the adoption of this statement to have a material impact on the Company's financial condition, results of operations or cash flows.

ACCOUNTING FOR SERVICING OF FINANCIAL ASSETS: In March 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 156, "Accounting for Servicing of Financial Assets- an amendment of FASB Statement No. 140." SFAS No.156 requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract in specific situations. Additionally, the servicing asset or servicing liability shall be initially measured at fair value; however, an entity may elect the "amortization method" or "fair value method" for subsequent balance sheet reporting periods. SFAS No.156 is effective as of an entity's first fiscal year beginning after September 15, 2006. Early adoption is permitted as of the beginning of an entity's fiscal year, provided the entity has not yet issued financial statements, including interim financial statements, for any period of that fiscal year. The Company does not expect the adoption of this statement to have a material impact on its financial condition, results of operations or cash flows.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (FAS 157). FAS 157 enhances existing guidance for measuring assets and liabilities using fair value. Prior to the issuance of FAS 157, guidance for applying fair value was incorporated in several accounting pronouncements. FAS 157 provides a single definition of fair value, together with a framework for measuring it, and requires additional disclosure about the use of fair value to measure assets and liabilities. FAS 157 also emphasizes that fair value is a market-based measurement, not an entity-specific measurement, and sets out a fair value hierarchy with the highest priority being quoted prices in active markets. Under FAS 157, fair value measurements are disclosed by level within that hierarchy. While FAS 157 does not add any new fair value measurements, it does change current practice. Changes to practice include: (1) a requirement for an entity to include its own credit standing in the measurement of its liabilities; (2) a modification of the transaction price presumption; (3) a prohibition on the use of block discounts when valuing large blocks of securities for broker-dealers and investment companies; and (4) a requirement to adjust the value of restricted stock for the effect of the restriction even if the restriction lapses within one year. FAS 157 is effective for financial statements issued for

Note #1 - Summary of Significant Accounting Policies, Continued

fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company has not determined the impact of adopting FAS 157 on its financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans (an amendment of FASB Statements No. 87, 88, 106, and 132R)* (FAS 158), requires an employer to: (a) Recognize in its statement of financial position an asset for a plan's over funded status or a liability for a plan's under funded status; (b) measure a plan's assets and its obligations that determine its funded status as of the end of the employer's fiscal year (with limited exceptions); and (c) recognize changes in the funded status of a defined benefit postretirement plan in the year in which the changes occur. Those changes will be reported in comprehensive income of a business entity and in changes in net assets of a not-for-profit organization. The requirement by FAS 158 to recognize the funded status of a benefit plan and the disclosure requirements of FAS 158 are effective as of the end of the fiscal year ending after December 15, 2006 for entities with publicly traded equity securities. The requirement to measure plan assets and benefit obligations as of the date of the employer's fiscal year-end statement of financial position is effective for fiscal years ending after December 15, 2008. The Company does not expect the adoption of FAS 158 to have a material effect on the financial position of the company at December 31, 2006.

In February of 2007, the FASB Issued SFAS No. 159, *Establishing the Fair Value Option for Financial Assets and Liabilities.* The Financial Accounting Standards Board has issued SFAS 159 to permit all entities to choose to elect, at specified election dates, to measure eligible financial instruments at fair value. An entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date, and recognize upfront costs and fees related to those items in earnings as incurred and not deferred. SFAS No. 159 applies to fiscal years beginning after November 15, 2007, with early adoption permitted for an entity that has also elected to apply the provisions of SFAS No. 157, Fair Value Measurements. An entity is prohibited from retrospectively applying SFAS No. 159, unless it chooses early adoption. SFAS No. 159 also applies to eligible items existing at November 15, 2007 (or early adoption date). The Company does not expect the adoption of FAS 159 to have a material effect on the Company's financial condition.

Note #2 - Investment Securities

At December 31, 2006 and 2005, the investment securities portfolio was comprised of securities classified as available-for-sale, in accordance with SFAS No. 115, resulting in investment securities available-for-sale being carried at fair value adjusted for amortization of premiums and accretions of discounts, and fair market value adjustments for securities transferred from available-for-sale.

(Dollars in thousands, except per share amounts)

The amortized cost and fair values of investment securities available-for-sale at December 31, 2006, were:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Obligations of U.S. Government agencies and corporations	$ 205	$ -	$ (4)	$ 201
Mortgage-backed securities	21,959	16	(381)	21,594
Obligations of state and political subdivisions	16,139	540	(38)	16,641
Other securities	9	-	-	9
Total	$ 38,312	$ 556	$ (423)	$ 38,445

The amortized cost and fair values of investment securities available-for-sale at December 31, 2005, were:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Obligations of U.S. Government agencies and corporations	$ 826	$ -	$ (20)	$ 806
Mortgage-backed securities	28,795	13	(518)	28,290
Obligations of state and political subdivisions	15,036	364	(103)	15,297
Other securities	9	-	-	9
Total	$ 44,666	$ 377	$ (641)	$ 44,402

There were no investment securities held-to-maturity at December 31, 2006 and December 31, 2005.

The amortized cost and fair values of investment securities available-for-sale at December 31, 2006, by contractual maturity are shown below. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Securities Available-for-Sale	
	Amortized Cost	Fair Value
Due in one year or less	$ 517	$ 515
Due after one year through five years	2,747	2,786
Due after five years through ten years	6,809	7,000
Due after ten years	6,280	6,550
Mortgage-backed securities	21,959	21,594
Total Securities	$ 38,312	$ 38,445

Proceeds from sales, maturities and principal reductions of investment securities available-for-sale during 2006, 2005, and 2004, were $500, $1,350, and $1,315, respectively. In 2006, there was a gross gain of $9 reported and there were no gross gains or losses reported during 2005 and 2004.

Proceeds from sales and maturities and principal reductions of mortgage-backed securities in 2006, 2005, and 2004, were $7,071, $13,537, and $14,723, respectively. There were no gross gains or losses reported during 2006 and 2005. In 2004 gross gains on these sales were $28. Unrealized (losses)/gains on investment securities and mortgage-backed securities included in shareholders' equity net of tax at December 31, 2006, 2005, and 2004 were $80, ($158), and $147, net of tax of $53, ($106) and $98 respectively.

Note #2 - Investment Securities, Continued

Securities having a carrying value and a fair value of approximately $21,645 and $25,366 at December 31, 2006 and 2005, respectively, were pledged to secure public deposits and for other purposes as required by law.

At the June 29, 2005 FASB Board meeting, the Board agreed to issue FSP FAS 115-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments* which will replace the guidance previously set forth in EITF 03-1, *The Meaning of Other-Than –Temporary Impairment and Its Application to Certain Investments.* This FSP effectively eliminates the accounting guidance provided in EITF-03-1 in favor of existing impairment recognition guidance under SFAS No. 115, SAB No. 59, APB No. 18, and EITF Topic D-44. The FSP is for periods beginning after September 15, 2005, but its adoption has not had a material impact on the Company's consolidated financial statements.

Those investment securities available for sale which have an unrealized loss position at December 31, 2006 and 2005, are detailed below: (amounts in thousands)

	Securities in a Loss Position for Less than 12 Months		Securities in a Loss Position for 12 Months or Longer		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
December 31, 2006						
Obligations of U.S. Government agencies and corporations	$ -	$ -	$ 201	$ (4)	$ 201	$ (4)
Mortgage-backed securities	379	(4)	19,603	(377)	19,982	(381)
Obligations of state and political subdivisions	1,311	(12)	872	(26)	2,183	(38)
Other securities	-	-				
Total	$ 1,690	$ (16)	$ 20,676	$ (407)	$ 22,366	$ (423)
December 31, 2005						
Obligations of U.S. Government agencies and corporations	$ -	$ -	$ 806	$ (20)	$ 806	$ (20)
Mortgage-backed securities	14,111	(250)	11,902	(268)	26,013	(518)
Obligations of state and political subdivisions	4,237	(83)	620	(20)	4,857	(103)
Other securities	-	-				
Total	$ 18,348	$ (333)	$ 13,328	$ (308)	$ 31,676	$ (641)

There are twenty two securities that have been in a loss position for twelve months or longer. These securities are guaranteed by either the U.S. Government or other governments. These unrealized losses relate principally to current interest rates for similar types of securities. In analyzing an issuer's financial condition, the Company considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's financial condition. As the Company has the ability to hold these securities until maturity, or for the foreseeable future, no declines are deemed to be other-than-temporary.

(Dollars in thousands, except per share amounts)

Note #3 - Loans

Major classifications of loans were:

	2006	2005
Commercial, financial and agricultural	$ 84,976	$ 60,050
Real Estate - construction	105,712	76,981
Real Estate - other	237,401	210,690
Home Equity lines of credit	10,792	14,398
Installment loans to individuals	5,598	5,620
All other loans (including overdrafts)	504	394
	444,983	368,133
Less: Deferred loan fees	(1,625)	(1,617)
Less: Allowance for loan losses	(4,081)	(3,881)
Total Loans	$ 439,277	$ 362,635
Loans held for sale	$ 1,764	$ 3,392

Concentration of Credit Risk

At December 31, 2006 and 2005, approximately $353,905 and $302,069 of the Bank's loan portfolio was collateralized by various forms of real estate. Such loans are generally made to borrowers located in San Luis Obispo County and Northern Santa Barbara County. The Bank attempts to reduce their concentration of credit risk by making loans which are diversified by project type. While management believes that the collateral presently securing this portfolio is adequate, there can be no assurances that significant deterioration in the California real estate market would not expose the Bank to significantly greater credit risk.

Loans serviced for others are not included in the accompanying balances sheets. The unpaid principal balance of loans serviced for others was $7.5 million, $3.6 million and $3.5 million at December 31, 2006, 2005 and 2004, respectively.

The following is a summary of the investment in impaired loans, the related allowance for loan losses, and income recognized thereon as of December 31:

	2006	2005	2004
Impaired loans with a valuation allowance	$ -	$ 54	$ 821
Impaired loans without a valuation allowance	55	-	113
Total impaired loans	$ 55	$ 54	$ 934
Valuation allowance related to impaired loans	$ -	$ 16	$ 453
Average recorded investment in impaired loans	$ 131	$ 374	$ 1,076
Cash receipts applied to reduce principal balance	$ 273	$ 8	$ 110
Interest income recognized for cash payments	$ -	$ -	$ 48

The provisions of SFAS No. 114 and SFAS No. 118 permit the valuation allowance reported above to be determined on a loan-by-loan basis or by aggregating loans with similar risk characteristics. Because the loans currently identified as impaired have unique risk characteristics, the valuation allowance was determined on a loan-by-loan basis.

(Dollars in thousands, except per share amounts)

Note #3 - Loans, Continued

Non-accruing loans totaled approximately $55 and $54 at December 31, 2006 and 2005, respectively. As of December 31, 2006 and 2005, all loans on non-accrual were classified as impaired. If interest on non-accrual loans had been recognized at the original interest rates, interest income would have increased $63, $87, and $126, in 2006, 2005, and 2004, respectively. No additional funds are committed to be advanced in connection with impaired loans.

At December 31, 2006 and 2005, the Bank had no loans past due 90 days or more and still accruing interest.

At December 31, 2006, there were no loans classified as troubled debt restructurings.

The Bank also originates Small Business Administration ("SBA") loans for sale to governmental agencies and institutional investors. At December 31, 2006 and 2005, the unpaid principal balance of SBA loans serviced for others totaled $1,355 and $1,715, respectively. The gain on sale of SBA loans was $19, $84, and $45 for the years ended December 31, 2006, 2005, and 2004, respectively.

Note #4 - Allowance for Loan Losses

Transactions in the allowance for loan losses are summarized as follows:

	2006	2005	2004
Balance, Beginning of Year	$ 3,881	$ 3,247	$ 3,070
Additions charged to operating expense	600	710	410
Loans charged off	(561)	(100)	(236)
Recoveries of loans previously charged off	161	24	3
Balance, End of Year	$ 4,081	$ 3,881	$ 3,247

Note #5 - Property, Premises and Equipment

Property, premises and equipment consisted of the following:

	2006	2005
Building and improvements	$ 12,578	$ 7,330
Furniture and equipment	5,759	4,641
	18,337	11,971
Less: Accumulated depreciation and amortization	7,540	6,652
	10,797	5,319
Land	3,784	3,782
Construction in progress	-	2,804
Total	$ 14,581	$ 11,905

During 2003, the Bank purchased land for future development of a Paso Robles, California administrative facility for approximately $1,100. The construction was completed and the Bank moved into the facility in June 2006.

In July 2005 the Company entered into a sale-leaseback transaction, with a non-affiliated party, for the Atascadero Branch Office with the Bank as the lessee. The sale price was $900 and resulted in a gain to the Company of

(Dollars in thousands, except per share amounts)

Note #5 - Property, Premises and Equipment, Continued

approximately $283 which is being amortized against rental expense over the first 5 year term of the lease. The Bank's new lease calls for payments of $5 per month for 5 years with 4 separate 5 year options to extend.

The Company leases land, buildings, and equipment under non-cancelable operating leases expiring at various dates through 2012. The following is a schedule of future minimum lease payments based upon obligations at year-end.

Year Ending December 31,	Amount
2007	$ 882
2008	948
2009	736
2010	616
2011	401
More than 5 years	205
Total	$ 3,788

The leases contain options to extend for periods from five to twenty years. Options to extend which have been exercised and the related lease costs are included above. Total expenditures charged for leases for the reporting periods ended December 31, 2006, 2005, and 2004, were approximately $628, $663, and $622, respectively.

The Company has four (4) subleases in place, three (3) of which are for additional space within existing branch offices. One sublease is for an entire facility that was vacated as the result of consolidation from the 2003 Hacienda Bank acquisition. The subleases are for various terms and accounted for approximately $197 credit to rental expense in 2006. The Company expects to receive sublease revenue for 2008 and 2009 of approximately $160 and $54, respectively.

Note #6 - Intangible Assets

Intangible assets consisted of core deposit intangibles subject to amortization with a net carrying value of $1,148 and $1,448, net of $1,375 and $1,075 accumulated amortization as of December 31, 2006 and 2005, respectively. Amortization expense for the periods ended December 31, 2006, 2005, and 2004 was $300, $573, and $421, respectively. The estimated future amortization expense for the next five years is $354 for 2007, $388 for 2008, $337 for 2009, $40 for 2010, and $29 for 2011.

Note #7 - Time Deposit Liabilities

At December 31, 2006, the Banks had time certificates of deposit with maturity distributions as follows:

Year Ending December 31,	
2007	$ 114,725
2008	4,601
2009	742
2010	1,338
	$ 121,406

(Dollars in thousands, except per share amounts)

Note #8 - Borrowings

The Bank has borrowing lines with correspondent banks totaling $13.5 million. At December 31, 2006 there were no balances outstanding on these borrowing lines.

Federal Home Loan Bank (FHLB) Advances

The Bank has established borrowing lines with the Federal Home Loan Bank (FHLB). At December 31, 2006, the Bank had the following borrowings, all of which are collateralized by loans, with the FHLB:

Amount Borrowed	Interest Rate	Variable/Fixed	Maturity Date
$ 10,000	5.44%	Fixed	26-Feb-07
$ 10,000	5.50%	Fixed	25-Jul-07
$ 10,000	5.39%	Variable- Daily	28-Sep-07
$ 10,000	5.37%	Variable- Daily	26-Nov-07
$ 10,000	5.37%	Variable- Daily	12-Dec-07
$ 50,000			

In addition, the Bank has an $11.7 million letter of credit secured by loans.

At December 31, 2006, the Bank has a remaining borrowing capacity with existing collateral of approximately $53 million and $9 million secured by loans and securities, respectively.

The Bank has pledged approximately $278.7 million in loans to the FHLB.

Securities Sold Under Agreements to Repurchase

Securities sold under agreements to repurchase, which are classified as secured borrowings, generally mature within one to four days from the transaction date. Securities sold under agreements to repurchase are reflected at the amount of cash received in connection with the transaction. As of December 31, 2006 and 2005, the Bank had $1,364 and $3,847 in securities sold under agreements to repurchase. Interest expense recorded was $88, $44, and $8 for the years ended December 31, 2006, 2005, and 2004, respectively. The carrying value of underlying securities provided as collateral for these transactions was $4,330 and $5,771 at December 31, 2006 and 2005, respectively.

Notes Payable

On October 10, 2005, the Company renewed a revolving line of credit in the amount of $3,500 through Pacific Coast Bankers Bank (PCBB). The line is secured by 51% of the outstanding shares of the Bank’s stock. The line bears interest at the Wall Street Journal prime rate. Interest payments are due quarterly. The line is scheduled to mature on October 10, 2007 at which time the line converts to an eight-year term loan maturing on October 10, 2015. Principal and interest payments are due quarterly. Under the terms of the agreement, the Company will not incur any additional debt over $2,000 exclusive of the inter-company debt and existing debt without prior written consent of PCBB. In addition, the Bank must be “well” capitalized on an on-going basis as defined by the Regulators. At December 31, 2006, the outstanding balance owed was $0.

(Dollars in thousands, except per share amounts)

Note #8 - Borrowings, Continued

Junior Subordinated Debentures

On April 10, 2002, the Company issued $8,248 of Floating Rate Junior Subordinated Deferrable Interest Debentures (the "debt securities") to Heritage Oaks Capital Trust I, a statutory trust created under the laws of the State of Delaware. These debt securities are subordinated to effectively all borrowings of the Company and are due and payable on April 22, 2032. Interest is payable quarterly on these debt securities at 6-Month LIBOR plus 3.7% for an effective rate of 9.09% as of December 31, 2006. The debt securities can be called at any time commencing on April 22, 2007, at par. The debt securities can also be redeemed at par if certain events occur that impact the tax treatment or the capital treatment of the issuance. The Company also purchased a 3% minority interest totaling $248 in Heritage Oaks Capital Trust I. The balance of the equity of Heritage Oaks Capital Trust I is comprised of mandatorily redeemable preferred securities and is included in other assets.

On October 27, 2006, the Company issued $8,248 of Floating Rate Junior Subordinated Deferrable Interest Debentures (the "debt securities") to Heritage Oaks Capital Trust II, a statutory trust created under the laws of the State of Delaware. These debt securities are subordinated to effectively all borrowings of the Company and are due and payable on October 27, 2036. Interest is payable quarterly on these debt securities at 3-Month LIBOR plus 1.71% for an effective rate of 7.10% as of December 31, 2006. The debt securities can be called at any time commencing on October 27, 2011, at par. The debt securities can also be redeemed at par if certain events occur that impact the tax treatment or the capital treatment of the issuance. The Company also purchased a 3% minority interest totaling $248 in Heritage Oaks Capital Trust II. The balance of the equity of Heritage Oaks Capital Trust II is comprised of mandatorily redeemable preferred securities and is included in other assets.

Under FASB Interpretation (FIN) No. 46, *"Consolidation of Variable Interest Entities, an interpretation of ARB No. 51,"* the Company is not allowed to consolidate Heritage Oaks Capital Trust I and II into the Company's financial statements. Prior to the issuance of FIN No. 46, Bank holding companies typically consolidated these entities. On February 28, 2005, the Federal Reserve Board issued a new rule which provides that, notwithstanding the deconsolidation of such trusts, junior subordinated debentures, such as those issued by the Company, may continue to constitute up to 25% of a bank holding company's Tier 1 capital, subject to certain new limitations which will not become effective until March 31, 2009 and which, in any event, are not expected to affect the treatment of the Company's Junior Subordinated Debentures as Tier 1 capital for regulatory purposes. As of December 31, 2006, the Company has included $14.35 million of the net junior subordinated debt in its Tier1 Capital for regulatory capital purposes.

Note #9 - Income Taxes

The current and deferred amounts of the provision (benefit) for income taxes were:

	Year Ending December 31,		
	2006	2005	2004
Federal Income Tax			
Current	$ 2,924	$ 3,045	$ 2,031
Deferred	(191)	(134)	16
Total Federal Taxes	2,733	2,911	2,047
State Franchise Tax			
Current	1,087	1,291	706
Deferred	(29)	(99)	6
Total State Franchise Tax	1,058	1,192	712
Total Income Taxes	$ 3,791	$ 4,103	$ 2,759

(Dollars in thousands, except per share amounts)

Note #9 - Income Taxes, Continued

The provision for taxes on income differed from the amounts computed using the federal statutory tax rate of 34 percent is as follows:

	2006		2005		2004	
	Amount	Percent	Amount	Percent	Amount	Percent
Tax provision at federal statutory tax rate	$ 3,554	34.0	$ 3,652	34.0	$ 2,497	34.0
State income taxes, net of federal income tax benefit	698	7.2	768	7.2	507	6.9
Tax exempt income and other, Net	(461)	(4.9)	(317)	(3.0)	(245)	(3.4)
Total Tax Provision	$ 3,791	36.3	$ 4,103	38.2	$ 2,759	37.5

The net deferred tax asset is determined as follows:

	2006	2005
Deferred Tax Assets		
Reserves for loan losses	$ 1,605	$ 1,414
Fixed assets	233	357
Accruals	1,233	800
Investment securities valuation	-	109
Deferred Fees	84	231
Net operating loss carryforward	345	506
Total Deferred Tax Assets	3,500	3,417
Deferred Tax Liabilities		
Fair value adjustment for purchased assets	363	480
Investment securities valuation	55	-
Deferred costs, prepaids and FHLB	668	579
Total Deferred Tax Liabilities	1,086	1,059
Net Deferred Tax Assets	$ 2,414	$ 2,358

As part of a transaction with Hacienda Bank, the Company has approximately $1.0 million of net operating losses (NOL) available for carry forward at December 31, 2006. The realization of the NOL is limited for federal tax purposes and for state tax purposes under current tax law. Any amount not utilized for federal tax purposes will expire on various years through 2014.

Note #10 - Commitments and Contingencies

The Company is involved in various litigation. In the opinion of management and the Company's legal counsel, the disposition of all such litigation pending will not have a material effect on the Company's financial statements.

In the normal course of business, the Bank enters into financial commitments to meet the financing needs of their customers. These financial commitments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk not recognized in the statement of financial position.

The Bank's exposure to loan loss in the event of nonperformance on commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments as they do for loans reflected in the consolidated financial statements.

(Dollars in thousands, except per share amounts)

Note #10 - Commitments and Contingencies, Continued

As of December 31, 2006 and 2005, the Bank had the following outstanding financial commitments whose contractual amount represents credit risk:

	2006	2005
Commitments to extend credit	$ 166,540	$ 167,698
Standby letters of credit	17,691	17,033
	$ 184,231	$ 184,731

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Standby letters of credit are conditional commitments to guarantee the performance of a Bank customer to a third party. Since many of the commitments and standby letters of credit are expected to expire without being drawn upon, the total amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained if deemed necessary by the Bank is based on management's credit evaluation of the customer.

Note #11 - Regulatory Matters

The Company (on a consolidated basis) and the Bank is subject to various regulatory capital requirements administered by federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Company's and the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of the Company's and the Bank's assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The Company's and the Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined) and of Tier 1 capital (as defined) to average assets (as defined). Management believes, as of December 31, 2006, that the Company and the Bank meets all capital adequacy requirements to which it is subject.

As of the most recent notification, the Federal Deposit Insurance Corporation categorized the Bank as well-capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the Bank's category. To be categorized as well-capitalized, the Bank must maintain minimum capital ratios as set forth in the table below. The following table also sets forth the Company's and the Bank's actual regulatory capital amounts and ratios:

(Dollars in thousands, except per share amounts)

Note #11 - Regulatory Matters, Continued

	Actual Regulatory		Capital Needed: For Capital Adequacy Purposes		Capital Needed: To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Capital Amount	Ratio	Capital Amount	Ratio	Capital Amount	Ratio
As of December 31, 2006						
Total capital to risk-weighted assets:						
Company	$ 61,973	12.36%	$ 40,112	8.0%	N/A	N/A
Heritage Oaks Bank	56,179	11.21%	40,092	8.0%	$ 50,115	10.0%
Tier 1 capital to risk-weighted assets:						
Company	57,729	11.51%	20,062	4.0%	N/A	N/A
Heritage Oaks Bank	51,935	10.37%	20,033	4.0%	30,049	6.0%
Tier 1 capital to average assets:						
Company	57,729	11.00%	20,993	4.0%	N/A	N/A
Heritage Oaks Bank	51,935	9.89%	21,005	4.0%	26,256	5.0%
As of December 31, 2005						
Total capital to risk-weighted assets:						
Company	$ 50,736	11.93%	$ 34,022	8.0%	N/A	N/A
Heritage Oaks Bank	48,071	11.33%	33,942	8.0%	$ 42,428	10.0%
Tier 1 capital to risk-weighted assets:						
Company	46,692	10.98%	17,010	4.0%	N/A	N/A
Heritage Oaks Bank	44,027	10.38%	16,966	4.0%	25,449	6.0%
Tier 1 capital to average assets:						
Company	46,692	9.61%	19,435	4.0%	N/A	N/A
Heritage Oaks Bank	44,027	9.11%	19,331	4.0%	24,164	5.0%

As disclosed in Note #8, Borrowings - Junior Subordinated Debentures, subject to percentage limitations, the proceeds from the issuance of trust preferred securities are considered Tier 1 capital by the Company for regulatory purposes. However, as a result of the issuance of FIN 46 and FIN 46R, the trust subsidiary is not consolidated in these financial statements and therefore the proceeds received by the Company from the trust subsidiary is reported as subordinated debt. On February 28, 2005, the Federal Reserve Board issued a new rule which provides that, notwithstanding the deconsolidation of such trusts, junior subordinated debentures, such as those issued by the Company, may continue to constitute up to 25% of a bank holding company's Tier 1 capital, subject to certain new limitations which will not become effective until March 31, 2009 and which, in any event, are not expected to affect the treatment of the Company's Junior Subordinated Debentures as Tier 1 capital for regulatory purposes.

Note #12 - Salary Continuation Plan

The Company established salary continuation plan-agreements with the President, Chief Financial Officer, Chief Lending Officer, Chief Administrative Officer and certain Senior Vice Presidents, as authorized by the Board of Directors. These agreements provide for annual cash payments for a period not to exceed 15 years, payable at age 60-65, depending on the agreement. In the event of death prior to retirement age, annual cash payments would be made to the beneficiaries for a determined number of years. The present values of the Company’s liability

Note #12 - Salary Continuation Plan, Continued

under these Agreements were approximately $1,617 and $1,250 at December 31, 2006 and 2005, respectively, and are included in other liabilities in the Company's Consolidated Financial Statements. The Company maintains life
insurance policies, which are intended to fund all costs of the plan. The cash surrender values of these life insurance policies totaled approximately $9,435 and $7,706, at December 31, 2006 and 2005, respectively.

Note #13 - Employee Benefit Plans

401(k) Pension Plan

During 1994, the Company established a savings plan for employees that allow participants to make contributions by salary deduction equal to 15 percent or less of their salary pursuant to section 401(k) of the Internal Revenue Code. Employee contributions are matched up to 25 percent of the employee's contribution. Employees vest immediately in their own contributions and they vest in the Company's contribution based on years of service. Expenses of the savings plan were approximately $148, $109, and $93, for the years ended December 31, 2006, 2005, and 2004, respectively.

Employee Stock Ownership Plan

The Company sponsors an employee stock ownership plan (ESOP) that covers all employees who have completed 12 consecutive months of service, are over 21 years of age and work a minimum of 1,000 hours per year. The amount of the annual contribution to the ESOP is at the discretion of the Board of Directors. The contributions made to this plan were approximately $364 in 2006, $216 in 2005 and $206 in 2004.

Note #14 – Share-Based Compensation Plans

At December 31, 2006, the Company had two stock option plans, which are described below.

The "1990 Stock Option Plan"
The Company adopted the 1990 Stock Option Plan, which is a tandem stock option plan permitting options to be granted either as "Incentive Stock Options" or as "Non-Qualified Stock Options" under the Internal Revenue Code. All outstanding options were granted at prices which equal the fair market value on the day of grant. Options granted vest at a rate of 25 percent per year for four years and expire no later than ten years from the date of grant. The plan provided for issuance of up to 350,075 shares of the Company's un-issued common stock and is subject to the specific approval of the Board of Directors. The Company's 1990 stock option plan expired in July 2000.

(Dollars in thousands, except per share amounts)

Note #14 – Equity Compensation Plans, Continued

The following tables summarize information about the 1990 stock option plan outstanding at December 31, 2006.

	2006			
	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value ($)
Outstanding at beginning of year	3,136	$ 2.55		
Granted				
Cancelled	-	$ -		
Exercised	-	$ -		
Outstanding at end of year	3,136	$ 2.55	0.53	$ 48,138
Options available for granting at end of year	-			
Options exercisable at year-end	3,136	$ 2.55	0.53	$ 48,138
Weighted-average fair value of options granted during the year	-			

The "1997 Stock Option Plan"
The Company adopted the 1997 Stock Option Plan, which is a tandem stock option plan permitting options to be granted either as "Incentive Stock Options" or as "Non-Qualified Stock Options" under the Internal Revenue Code. All outstanding options were granted at prices which equal the fair market value on the day of the grant. Options granted vest at a rate of 20 percent per year for five years, and expire no later than ten years from the date of grant. The plan provides for issuance of up to 427,531 shares of the Company's unissued common stock and is subject to the specific approval of the Board of Directors.

During 1999, the Board of Directors approved an amendment to the 1997 Stock Option Plan. Under this amendment, the plan provides for issuance of up to 241,288 additional shares of the Company's common stock.

On May 26, 2005, the stockholders of the Company approved the 2005 Equity Based Compensation Plan (the "2005 Plan"). Pursuant to stockholder approval, no further grants will be made from the 1997 Stock Option Plan.

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

	For the yeard ended	
	31-Dec-05	31-Dec-04
Dividend Yield	0.00%	0.00%
Expected life (years)	7.50	10.00
Expected volatility	24.00%	24.00%
Risk-free rate	4.11%	4.22%
Weighted average grant date fair value of options granted	$ 5.24	$ 4.89

No options were granted during 2006.

(Dollars in thousands, except per share amounts)

Note #14 – Equity Compensation Plans, Continued

The following summarizes information about the 1997 stock option plan outstanding at December 31, 2006.

	2006			
	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value ($)
Outstanding at beginning of year	522,780	$ 5.20		
Granted	-	$ -		
Cancelled	(1,739)	$ 6.48		
Exercised	(87,607)	$ 3.95		
Outstanding at end of year	433,434	$ 5.45	3.65	$ 5,396
Options available for granting at end of year	-			
Options exercisable at year-end	368,525	$ 4.51		$ 4,935
Weighted-average fair value of options granted during the year	-			

The total intrinsic value (which is the amount by which the stock price exceeded the exercise price on the date of exercise) of options exercised during the three years ended 2006, 2005 and 2004 was $887, $2,043 and $340, respectively. The Company received income tax benefits of $365, $588 and $136 for the years ended December 31, 2006, 2005 and 2004, respectively, related to the exercise of non-qualified employee stock options, and disqualifying dispositions in the exercise of incentive stock options. Prior to the adoption of SFAS No. 123R, the Company presented all tax benefits of deductions resulting from the exercise of stock options as operating cash flows in the Statement of Cash flows. SFAS No. 123R requires the cash flows from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) to be classified as financing cash flows. The amount of excess tax benefit classified as a financing cash flow in at December 31, 2006 was $365. As of December 31, 2006, there was approximately $256 of total unrecognized compensation cost related to non-vested stock options which is expected to be recognized over a period of 3.1 years.

The “2005 Equity Based Compensation Plan”
On May 26, 2005, the stockholders of the Company approved the 2005 Equity Based Compensation Plan (the “2005 Plan”). Upon approval by stockholders, no further grants would be made from the 1997 Stock Option Plan. The 2005 Plan authorizes the granting of Incentive Stock Options, Non-Qualified Stock Options, Stock Appreciation Rights (“SARs”), Restricted Stock Awards, Restricted Stock Units and Performance Share Cash Only Awards. The 2005 Plan provides for a maximum of ten percent (10%) of the Company’s issued and outstanding shares of common stock as of March 25, 2005 and adjusted on each anniversary thereafter to be ten percent (10%) of the then issued and outstanding number of shares.

The Company grants restricted stock periodically as a part of the 2005 Plan for the benefit of employees. Restricted shares issued are typically new shares and currently vest in five years with a “cliff” vesting. The

(Dollars in thousands, except per share amounts)

Note #14 – Equity Compensation Plans, Continued

following table summarizes information about non-vested restricted shares as of December 31, 2006 and changes for the year ended December 31, 2006:

	For the year ended December 31, 2006		
	Restricted Shares Outstanding		Average Grant Date Fair Value
Balance, beginning of period	3,750	$	16.57
Granted	67,050	$	19.00
Vested	-	$	-
Forfeited/expired	(4,750)	$	17.11
Balance, end of period	66,050	$	19.00

The compensation cost related to restricted stock that has been charged against income (included in salaries and employee benefits) was $220 and $3 for the years ended December 31, 2006 and 2005, respectively. The total income tax benefit recognized in the income statement related to restricted stock was $80 for the year ended December 31, 2006. No restricted shares vested during 2006 and 2005. At December 31, 2006, there was $1,038 of total unrecognized compensation cost related to non-vested restricted stock which is expected to be recognized over a weighted-average period of 4.0 years.

Note #15 - Related Party Transactions

The Bank has entered into loan and deposit transactions with certain directors and executive officers of the Bank and the Company. These loans were made and deposits were taken in the ordinary course of the Bank's business and, in management's opinion, were made at prevailing rates and terms.

An analysis of loans to directors and executive officers is as follows:

	2006		2005	
Outstanding Balance, Beginning of Year	$	14,603	$	5,213
Additional loans made		3,715		10,181
Repayments		(2,840)		(791)
Outstanding Balance, End of Year	$	15,478	$	14,603

Deposits from related parties held by the Bank at December 31, 2006 and 2005 amounted to approximately $3,513 and $3,619, respectively.

Note #16 - Restriction on Transfers of Funds to Parent

There are legal limitations on the ability of the Bank to provide funds to the Company. Dividends declared by the Bank may not exceed, in any calendar year, without approval of the California Department of Financial Institutions (DFI), its respective net income for the year and the retained net income for the preceding two years. Section 23A of the Federal Reserve Act restricts the Bank from extending credit to the Company and other affiliates amounting to more than 20 percent of its contributed capital and retained earnings.

(Dollars in thousands, except per share amounts)

Note #17 - Fair Value of Financial Instruments

The fair value of a financial instrument is the amount at which the asset or obligation could be exchanged in a current transaction between willing parties, other than a forced or liquidation sale. Fair value estimates are made at a specific point in time based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the entire holdings or a particular financial instrument. Because no market value exists for a significant portion of the financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature, involve uncertainties and matters of judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value estimates are based on financial instruments both on and off the balance sheet without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Additionally, tax consequences related to the realization of the unrealized gains and losses can have a potential effect on fair value estimates and have not been considered in many of the estimates.

The estimated fair value of financial instruments at December 31 is summarized as follows:

	2006		2005	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Assets				
Cash and cash equivalents	$ 23,034	$ 23,034	$ 44,559	$ 44,559
Interest-bearing deposits	318	318	298	298
Investments and mortgage-backed securities	38,445	38,445	44,402	44,402
FHLB and FRB stock	2,350	2,350	1,885	1,885
Loans receivable, net of deferred fees and costs	443,358	444,396	366,516	364,652
Loans held for sale	1,764	1,764	3,392	3,392
Accrued interest receivable	2,627	2,627	1,977	1,977
Liabilities				
Noninterest-bearing deposits	153,005	153,005	164,014	164,014
Interest-bearing deposits	267,516	268,991	253,783	253,958
FHLB advances	50,000	50,163	10,000	10,071
Securities sold under repurchase agreements	1,364	1,364	3,847	3,847
Notes payable	-	-	-	-
Junior Subordinated Debentures	16,496	16,352	8,248	8,248
Accrued interest payable	851	851	511	511
	Notional Amount	Cost to Cede or Assume	Notional Amount	Cost to Cede or Assume
Off-Balance Sheet Instruments				
Commitments to extend credit and standby letters of credit	$ 184,231	$ 1,842	$ 184,731	$ 1,847

The following methods and assumptions were used by the Company in estimating fair value disclosures:

- <u>Cash and Cash Equivalents</u>

The carrying amounts reported in the balance sheet for cash and cash equivalents approximate those assets' fair values due to the short-term nature of the assets.

- <u>Interest Bearing Deposits</u>

Note #17 - Fair Value of Financial Instruments, Continued

Fair values for time deposits are estimated using a discounted cash flow analysis that applies interest rates currently being offered on certificates to a schedule of aggregated contractual maturities on such time deposits.

- Investment and Mortgage-Backed Securities

Fair values are based upon quoted market prices, where available.

- Loans and Loans Held for Sale

For variable-rate loans that re-price frequently and with no significant change in credit risk, fair values are based on carrying amounts. The fair values for other loans (for example, fixed rate commercial real estate and rental property mortgage loans and commercial and industrial loans) are estimated using discounted cash flow analysis, based on interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Loan fair value estimates include judgments regarding future expected loss experience and risk characteristics. The carrying amount of accrued interest receivable approximates its fair value.

- Deposits

The fair values disclosed for demand deposits (for example, interest-bearing checking accounts and passbook accounts) are, by definition, equal to the amount payable on demand at the reporting date (that is, their carrying amounts). The fair values for certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated contractual maturities on such time deposits. The carrying amount of accrued interest payable approximates fair value.

- FHLB Advances

The fair value disclosed for FHLB advances is determined by discounting contractual cash flows at current market interest rates for similar instruments.

- Securities Sold Under Agreement to Repurchase

The carrying amounts reported in the balance sheets for securities sold under agreement to repurchase approximate those liabilities' fair values due to the short-term nature of the liabilities.

- Junior Subordinated Debentures

The fair value disclosed for junior subordinated debentures is based on carrying amounts. The debentures are variable-rate notes that re-price frequently.

- Off-balance Sheet Instruments

Fair values of commitments to extend credit and standby letters of credit are based upon fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreement and the counterparties' credit standing.

(Dollars in thousands, except per share amounts)

Note #18 - Earnings Per Share (EPS)

The following is a reconciliation of net income and shares outstanding to the income and number of shares used to compute EPS. Share information has been retroactively adjusted for the stock dividend as discussed in Note #20.

	2006		2005		2004	
	Net Income	Shares	Net Income	Shares	Net Income	Shares
Net income as reported	$ 6,662		$ 6,637		$ 4,584	
Shares outstanding at year-end		6,345,639		6,231,982		6,013,260
Impact of weighting shares purchased during the year		(11,715)		(64,045)		(22,762)
Used in Basic EPS	6,662	6,333,924	6,637	6,167,937	4,584	5,990,498
Dilutive effect of outstanding stock options		261,869		383,452		444,270
Used in Dilutive EPS	$ 6,662	6,595,793	$ 6,637	6,551,389	$ 4,584	6,434,768

Note #19 - Other Income/Expense

The following is a breakdown of fees and other income and expenses for the years ended December 31, 2006, 2005, and 2004:

	2006	2005	2004
Fees and Other Income			
ATM/Debit Card Transaction/Interchange Fees	$ 711	$ 629	$ 583
Bankcard merchant fees	122	160	116
Mortgage origination fees	552	897	602
Earnings on cash surrender value of life insurance policies	393	323	294
Other	757	482	446
	$ 2,535	$ 2,491	$ 2,041
Other Expenses			
Data processing	$ 2,138	$ 2,200	$ 2,570
Advertising and promotional	851	582	515
Regulatory fees	112	106	114
Other professional fees and outside services	1,207	802	530
Legal fees and other litigation expenses	154	122	76
Loan department costs	147	182	181
Stationery and supplies	327	311	374
Director fees	290	247	179
Core deposit amortization	300	573	421
Other	1,249	1,356	1,212
Total	$ 6,775	$ 6,481	$ 6,172

Note #20 – Cash Dividends, Stock Dividends and Stock Splits

Stock Dividends and Stock Splits

On March 26, 2004, the Board of Directors declared a five percent stock dividend payable on April 23, 2004 to stockholders of record on April 9, 2004. Cash was paid in lieu of fractional shares at the rate of $17.00 per share and amounted to $6.

On March 25, 2005, the Board of Directors declared a five percent stock dividend payable on April 22, 2005 to stockholders of record on April 8, 2005. Cash was paid in lieu of fractional shares at the rate of $20.15 per share and amounted to $8.

On October 21, 2005, the Board of Directors declared a 3-for-2 stock split payable on December 2, 2005 to stockholders of record on November 10, 2005. Cash was paid in lieu of fractional shares at the rate of $18.86 per share and amounted to $5.

All references in financial statements and notes to financial statements to number of shares, per share amounts, and market prices of the Company's common stock have been restated to reflect the increased number of shares outstanding.

Cash Dividends

On April 21, 2006, the Board of Directors of Heritage Oaks Bancorp, declared a special $0.25 cents per-share dividend for all shareholders of record on May 8, 2006, payable on May 19, 2006.

On July 21, 2006, the Board of Directors of Heritage Oaks Bancorp, declared the Company's first quarterly cash dividend of $0.08 cents per-share for all shareholders of record on August 11, 2006, payable on August 25, 2006.

On October 20, 2006, the Board of Directors of Heritage Oaks Bancorp, the Board declared an $0.08 per-share quarterly cash dividend for all shareholders of record on November 3, 2006, payable on November 17, 2006.

Note #21- Stock Repurchase Program

In July 2006, the Company adopted a stock repurchase program authorizing the repurchase of up to 40,000 shares of Company stock. In October 2006, the Board of Directors approved the authorization to repurchase an additional 60,000 shares of Company stock to its current stock repurchase program, which now provides for a total of up to 100,000 shares. Purchases are to be made, as conditions warrant, from time to time in the open market. The duration of the program is one year and the timing of purchases will depend on market conditions.

During the year ended December 31, 2006, 40,000 shares were repurchased and retired under the repurchase program. As of December 31, 2006, under the plan, the Company has the authority to purchase 60,000 shares of Company stock through July 2007.

(Dollars in thousands)

Note #22 - Condensed Financial Information of Heritage Oaks Bancorp (Parent Company)

Balance Sheets

	2006	2005
Assets		
Cash	$ 7,276	$ 487
Federal funds sold	-	2,150
Total cash and cash equivalents	7,276	2,637
Prepaid and other assets	627	443
Investment in subsidiaries	58,523	50,428
Total Assets	$ 66,426	$ 53,508
Liabilities and Stockholders' Equity		
Notes payable	$ -	$ -
Junior subordinated debentures	16,496	8,248
Other liabilities	458	415
Total Liabilities	16,954	8,663
Stockholders' Equity		
Common stock	29,583	29,255
Retained earnings	19,889	15,590
Total Stockholders' Equity	49,472	44,845
Total Liabilities and Stockholders' Equity	$ 66,426	$ 53,508

(Dollars in thousands)

Note #22 - Condensed Financial Information of Heritage Oaks Bancorp (Parent Company), Continued

Statements of Income

	2006	2005	2004
Income			
Equity in undisbursed income of subsidiaries	$ 7,297	$ 7,201	$ 5,039
Interest income	73	65	21
Other	-	31	57
Total Income	7,370	7,297	5,117
Expense			
Salary expense	114	85	75
Equipment expense	(57)	(10)	15
Other professional fees and outside services	254	268	130
Interest expense	839	583	517
Other	-	126	112
Total Expense	1,150	1,052	849
Total Operating Income	6,220	6,245	4,268
Income tax benefit	(442)	(392)	(316)
Net Income	$ 6,662	$ 6,637	$ 4,584

(Dollars in thousands)

Note #22 - Condensed Financial Information of Heritage Oaks Bancorp (Parent Company), Continued

Statements of Cash Flows

	2006	2005	2004
Cash Flows From Operating Activities			
Net income	$ 6,662	$ 6,637	$ 4,584
Adjustments to Reconcile Net Income to Net Cash Provided By/(Used in) Operating Activities			
Depreciation	-	8	15
Increase in other assets	(981)	(56)	229
Increase in other liabilities	281	18	10
Share-based compensation expense	25	-	-
Undistributed income of subsidiaries	(7,297)	(7,201)	(5,039)
Net Cash Used In Operating Activities	(1,310)	(594)	(201)
Cash Flows From Investing Activities			
Net Proceeds from sale of fixed assets	-	900	-
Contribution to subsidiary	311	-	-
Net Cash Provided By/(Used In) Investing Activities	311	900	-
Cash Flows From Financing Activities			
Cash dividends received	-	-	3,500
Cash paid in lieu of fractional shares	-	(12)	(6)
Cash dividends paid	(2,602)	-	-
Issuance of junior subordinated debentures	8,248	-	-
Increase/(decrease) in notes payable	-	-	(3,500)
Stock repurchased	(720)	-	-
Proceeds from the exercise of options	712	1,275	335
Net Cash Provided By Financing Activities	5,638	1,263	329
Net Increase in Cash and Cash Equivalents	4,639	1,569	128
Cash and Cash Equivalents, Beginning of Year	2,637	1,068	940
Cash and Cash Equivalents, End of Year	$ 7,276	$ 2,637	$ 1,068

Note #23 - Quarterly Financial Information (unaudited)

The following table provides a summary of results for the periods indicated:

	For the quarters ended							
(Dollars in thousands, except per share data)	December 31, 2006	September 30, 2006	June 30, 2006	March 31, 2006	December 31, 2005	September 30, 2005	June 30, 2005	March 31, 2005
Interest income	$ 9,932	$ 9,568	$ 8,666	$ 8,206	$ 8,349	$ 7,940	$ 7,139	$ 6,748
Net interest income	6,951	7,022	6,635	6,447	6,787	6,593	6,015	5,763
Provision for credit losses	120	180	180	120	180	170	180	180
Non-interest income	1,301	1,222	1,211	1,218	1,222	1,389	1,267	1,132
Other expenses	5,539	5,384	5,048	4,984	4,857	4,875	4,563	4,423
Income before provision for income taxes	2,593	2,680	2,618	2,561	2,972	2,937	2,539	2,292
Net income	$ 1,649	$ 1,733	$ 1,673	$ 1,606	$ 1,809	$ 1,805	$ 1,606	$ 1,417
Earnings per common share:								
Basic	$ 0.26	$ 0.27	$ 0.26	$ 0.26	$ 0.29	$ 0.29	$ 0.26	$ 0.23
Diluted	$ 0.25	$ 0.26	$ 0.25	$ 0.24	$ 0.27	$ 0.28	$ 0.25	$ 0.22

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

None.

ITEM 9A. CONTROLS AND PROCEDURES.

As required by SEC Rule 13a-15(b), the Company carried out an evaluation, under the supervision and with the participation of the Company’s management, including the Company’s Chief Executive Officer along with the Company’s Chief Financial Officer, of the effectiveness of the design and operation of the Company’s disclosure controls and procedures as of the end of the period covered by this report. The evaluation of disclosure controls and procedures includes an evaluation of some components of the Company’s internal control over financial reporting, and internal control over financial reporting is also separately evaluated on an annual basis for purposes of providing the management report which is set forth below. Based upon that evaluation, the Company’s Chief Executive Officer along with the Company’s Chief Financial Officer concluded that the Company’s disclosure controls and procedures are effective in timely alerting them to material information relating to the Company (including its consolidated subsidiary) required to be included in the Company’s periodic SEC filings. There have been no significant changes in the Company’s internal control over financial reporting during the Company’s most recent fiscal quarter that have materially affected, or are likely to materially affect, the Company’s internal control over financial reporting.

Disclosure controls and procedures are the Company’s controls and other procedures that are designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms. These controls and subsequent results are communicated to executive management providing the ability to make timely decisions regarding required disclosure.

ITEM 9B. OTHER INFORMATION.

None.

PART III

ITEM 10. DIRECTORS,,EXECUTIVE OFFICERS OF THE REGISTRANT, AND CORPORATE GOVERNANCE

Code of Ethics

We have adopted a Code of Conduct, which applies to all employees, officers and directors of the Company and Bank. Our Code of Conduct meets the requirements of a "code of ethics" as defined by Item 406 of Regulation S-K and applies to our Chief Executive Officer, Chief Financial Officer and Chief Accounting Officer, as well as all other employees, as indicated above. Our Code of Conduct is posted on our website at *www.heritageoaksbancorp.com* under the heading "Investor Relations – Governance Documents." Any change to or waiver of the code of conduct (other than technical, administrative and other non-substantive changes) will be posted on the Company's website or reported on a Form 8-K filed with the Securities and Exchange Commission. While the Board may consider a waiver for an executive officer or director, the Board does not expect to grant such waivers.

There have been no material changes to the procedures by which security holders may recommend nominees to the Company's Board during 2006.

The balance of the information required by Item 10 of Form 10-K is incorporated by reference from the information contained in the Company's Proxy Statement for the 2007 Annual Meeting of Shareholders which will be filed pursuant to Regulation 14-A

ITEM 11. EXECUTIVE COMPENSATION.

The information required by Item 11 of Form 10-K is incorporated by reference from the information contained in the Company's Proxy Statement for the 2007 Annual Meeting of Shareholders which will be filed pursuant to Regulation 14-A.

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

The information required by Item 12 of Form 10-K is incorporated by reference from the information contained in the Company's Proxy Statement for the 2007 Annual Meeting of Shareholders which will be filed pursuant to Regulation 14-A. See (Item 5. Market For Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities).

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

The information required by Item 13 of Form 10-K is incorporated by reference from the information contained in the Company's Proxy Statement for the 2007 Annual Meeting of Shareholders which will be filed pursuant to Regulation 14-A.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES.

The information required by Item 14 of Form 10-K is incorporated by reference from the information contained in the Company's Proxy Statement for the 2007 Annual Meeting of Shareholders which will be filed pursuant to Regulation 14-A.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES.

(b) Exhibits:

(2.1a)	Branch Purchase and Assumption Agreement and Real Property Purchase Agreement entered into between Westamerica Bank and Heritage Oaks Bank, dated July 16, 2001 filed with the SEC in the Company's 10-QSB for the period ending June 30, 2001.
(2.1b)	Agreement to Merge and Plan of Reorganization, dated June 11, 2003, filed with the SEC in the Company's 8-K of June 12, 2003.
(3.1a)	Articles of Incorporation incorporated by reference from Exhibit 3.1a to Registration Statement on Form S-4 No. 33-77504 filed with the SEC on April, 1994.
(3.1b)	Amendment to the Articles of Incorporation filed with the Secretary of State on October 16, 1997 filed with the SEC in the Company's 10-KSB for the year ending December 31, 1997.
(3.2)	The Company Bylaws as amended November 16, 2000 filed with the SEC in the Company's 10-KSB for the year ended December 31, 2000.
(4.1)	Specimen form of The Company stock certificate incorporated by reference from Exhibit 4.1 to Registration Statement on Form S-4 No. 33-77504 filed with the SEC on April 8, 1994.
(10.1)	1990 Stock Option Plan incorporated by reference from Exhibit 10.2 to Registration Statement on Form S-4 No. 33-77504, filed with the SEC on April 8, 1994.
(10.2)	Form of Stock Option Agreement incorporated by reference from Exhibit 4.2 to Registration Statement on Form S-4 No. 33-77504, filed with the SEC on April 8, 1994.
(10.3)	Lawrence P. Ward Employment Letter Agreement, dated February 28, 2002, filed with the SEC in the Company's 10-KSB Report for the year ended December 31, 2001.
(10.4)	401(k) Pension and Profit Sharing Plan filed with the SEC in the Company's 10K Report for the year ended December 31, 1994.
(10.5)	The Company 1995 Bonus Plan, filed with the SEC in the Company's 10K Report for the year ended December 31, 1994.
(10.6)	Salary Continuation Agreement with Lawrence P. Ward, filed with the SEC in the Company's 10-QSB Report for the quarter ended March 31, 2001.

(10.7) Salary Continuation Agreement with Gwen R. Pelfrey, filed with the SEC in the Company's 10K Report for the year ended December 31, 1994.

(10.8) Woodland Shopping Center Lease, filed with the SEC in the Company's 10K Report for the year ended December 31, 1994.

(10.9) 1135 Santa Rosa Street Lease, filed with the SEC in the Company's 10KSB Report for the year ended December 31, 1995.

(10.10) Lease Agreement for Cambria Branch Office dated February 21, 1997 filed with the SEC in the Company's 10KSB reported for the year ended December 31,1996.

(10.11) 1997 Stock Option Plan incorporated by reference from Exhibit 4a to Registration Statement on Form S-8 No.333-31105 filed with the SEC on July 11, 1997 as amended, incorporated by reference, from Registration Statement on Form S-8, File No. 333-83235 filed with the SEC on July 20, 1999.

(10.12) Form of Stock Option Agreement incorporated by reference from Exhibit 4b to Registration Statement on Form S-8 No. 333-31105 filed with the SEC on July 11, 1997.

(10.13) Madonna Road Lease filed with the SEC in the Company's 10KSB for the year ended December 31, 1997.

(10.14) Santa Maria lease commencing November 1, 1998 filed with the SEC in the Company's 10-KSB for the year ended December 31, 1998.

(10.15) Master data processing agreement with Mid West payment Systems, Inc. commencing October 1, 1998 filed with the SEC in the Company's 10-KSB for the year ended December 31, 1998.

(10.16) Salary Continuation Agreement with Margaret A. Torres, filed with the SEC in the Company's 10KSB Report for the year ended December 31, 1999.

(10.17) Salary Continuation Agreement with Paul Tognazzini, filed with the SEC in the Company's 10-KSB Report for the year ended December 31, 2001.

(10.18) Atascadero Branch Lease entered into on March 31, 1999. filed with the SEC in the Company's 10-KSB reported for the year ended December 31,1999.

(10.19) Service Bureau Processing Agreement entered into between Alltel Information Services, Inc. and Heritage Oaks Bank, dated August 1, 1999. Filed with the SEC in the Company's 10-KSB reported for the year ended December 31, 1999.

(10.20) ASSET PURCHASE AGREEMENT entered into between Travelex America, Inc. and Heritage Oaks Bank, dated November 21 , 2000 filed with the SEC in the Company's 10-KSB reported for the year ended December 31, 2000.

(10.21) Change in Terms Agreement and Business Loan Agreement entered into between the Company and Pacific Coast Banker's Bank on November 8, 2000, filed with the SEC in the Company's 10-KSB reported for the year ended December 31, 2001.

(10.22) Executive Salary Continuation Agreement dated February 1, 2002 between Heritage Oaks Bank and Margaret A. Torres, filed with the SEC in the Company's 10-QSB reported for March 31, 2002.

(10.23) Executive Salary Continuation Agreement dated February 1, 2002 between Heritage Oaks Bank and Paul Tognazzini, filed with the SEC in the Company's 10-QSB reported for March 31, 2002.

(10.24) Executive Salary Continuation Agreement dated February 1, 2002 between Heritage Oaks Bank and Gwen R. Pelfrey, filed with the SEC in the Company's 10-QSB reported for March 31, 2002.

(10.25) Executive Salary Continuation Agreement dated February 1, 2002 between Heritage Oaks Bank and Gloria Brady, filed with the SEC in the Company's 10-QSB reported for March 31, 2002.

(10.26) Executive Salary Continuation Agreement dated February 1, 2002 between Heritage Oaks Bank and Joe Carnevali, filed with the SEC in the Company's 10-QSB reported for March 31, 2002.

(10.27) Executive Salary Continuation Agreement dated February 1, 2002 between Heritage Oaks Bank and Donna Breuer, filed with the SEC in the Company's 10-QSB reported for March 31, 2002.

(10.28) Executive Salary Continuation Agreement dated February 1, 2002 between Heritage Oaks Bank and Chris Sands, filed with the SEC in the Company's 10-QSB reported for March 31, 2002.

(10.29) Money Access Services Processing Agreement for ATM processing, signed on October 3, 2002, filed with the SEC in the Company's 10QSB reported for September 30, 2002.

(10.30) The Company Employee Stock Ownership Plan, Summary Plan Description, filed with the SEC in the Company's 10-KSB reported for December 31, 2002.

(10.31) The Company Employee Stock Ownership Plan, Summary of Material Modifications to the Summary Plan Description dated July 2002, filed with the SEC in the Company's 10-KSB reported for December 31, 2002.

(10.32) A Construction Agreement dated February 12, 2003 between Heritage Oaks Bank and HBE financial Facilities, a Division of HBE Corporation, filed with the SEC in the Company's 10-QSB for March 31, 2003.

(10.33) Executive Salary Continuation Agreement dated July 1, 2003 between Heritage Oaks Bank and Mark Stasinis, filed with the SEC in the Company's 10-QSB reported for June 30, 2003.

(10.34) Executive Salary Continuation Agreement dated July 1, 2003 between Heritage Oaks Bank and Kelley Stolz, filed with the SEC in the Company's 10-QSB reported for June 30, 2003.

(10.35) Executive Salary Continuation Agreement dated July 1, 2003 between Heritage Oaks Bank and Paul Deline, filed with the SEC in the Company's 10-QSB reported for June 30, 2003.

(10.36) Executive Salary Continuation Agreement dated July 1, 2003 between Heritage Oaks Bank and Mitch Massey, filed with the SEC in the Company's 10-QSB reported for June 30, 2003.

(10.37) Employment Agreement with David Duarte, President and Chief Operating Officer of Hacienda Bank, dated September 5, 2003 and filed with the SEC in the Company's 10-QSB reported for September 30, 2003.

(10.38) Promissory Note executed on October 3, 2003 for $3.5 million with Pacific Coast Bankers Bank, filed with the SEC in the Company's 10-QSB reported for September 30, 2003.

(10.39) Employment Agreement with Lawrence P. Ward, President and Chief Executive Officer of Heritage Oaks Bank, dated February 1, 2004 and filed with the SEC in the Company's 10-KSB reported for December 31, 2003.

(10.40) Executive Salary Continuation Agreement dated November 1, 2003 between Hacienda Bank and David Duarte, filed with the SEC in the Company's 10-KSB reported for December 31, 2003.

(10.41) Fifth Amendment to Service Bureau Processing Agreement dated June 19, 2004 between Fidelity Information Services, Inc. and Heritage Oaks Bank, filed with the SEC in the Company's 10QSB for June 30, 2004.

(10.42) Atascadero Branch Lease entered into on July 15, 2005, filed with the SEC in the Company's 10-Q for the quarter ended September 30, 2005

(14) Code of Ethics, filed with the SEC in the Company's 10-KSB for the year ended December 31, 2003.

(21) Subsidiaries of the Company. Heritage Oaks Bank is the only financial subsidiaries of the Company.

(23) Consent of Independent Registered Accounting Firm

(31.1) Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

(31.2) Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

(32.1) Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(32.2) Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

SIGNATURES

Pursuant to the requirements of Section 13 of the Securities Exchange Act of 1934, the Company has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.
THE COMPANY

/s/ Lawrence P. Ward	/s/ Margaret A. Torres
LAWRENCE P. WARD	MARGARET A. TORRES
President and Chief Executive Officer	Executive Vice President, Chief Financial Officer
Dated: March 1, 2007	and Principal Accounting Officer
	Dated: March 1, 2007

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

/s/ B.R. Bryant B.R. BRYANT	Chairman of the Board	March 1, 2007
/s/ Donald H. Campbell DONALD H. CAMPBELL	Vice Chairman of the Board of Directors	March 1, 2007
/s/ Kenneth Dewar KENNETH DEWAR	Director	March 1, 2007
/s/ Mark C. Fugate MARK C. FUGATE	Director	March 1, 2007
/s/ Dolores T. Lacey DOLORES T. LACEY	Director	March 1, 2007
/s/ Merle F. Miller MERLE F. MILLER	Director	March 1, 2007
/s/ Michael Morris MICHAEL MORRIS	Director	March 1, 2007
/s/ Daniel J. O’Hare DANIEL J. O’HARE	Director	March 1, 2007
/s/ Alex Simas ALEX SIMAS	Director	March 1, 2007
/s/ Ole K. Viborg OLE K. VIBORG	Director	March 1, 2007
/s/ Lawrence P. Ward LAWRENCE P. WARD	Director	March 1, 2007

EXHIBIT INDEX

Exhibit Sequential Number	Description
23	Consent of Independent Accountants
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

EXHIBIT 23

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in Registration Statements No. 333-07589, No. 333-31105, No. 333-83235, and No. 333-126876 each on Form S-8, of our report dated March 1, 2007 on our audits of the consolidated financial statements of Heritage Oaks Bancorp and Subsidiaries and management's assessment of the effectiveness of internal control over financial reporting and the effectiveness of internal control over financial reporting appearing in this Annual Report on Form 10-K.

/s/ Vavrinek, Trine, Day & Co., LLP

Rancho Cucamonga, California
March 1, 2007

Exhibit 31.1
CERTIFICATIONS

I, Lawrence P. Ward, certify that:

1. I have reviewed this annual report on Form 10-K of Heritage Oaks Bancorp;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision,
   to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
   b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
   c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal controls over financial reporting, to the registrant's auditors and audit committee of the registrant's board of directors (or persons performing the equivalent function);

   a) all significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 1, 2007

/s/ Lawrence P. Ward
Lawrence P. Ward
Chief Executive Officer

Exhibit 31.2
CERTIFICATIONS

I, Margaret A. Torres, certify that:

1. I have reviewed this annual report on Form 10-K of Heritage Oaks Bancorp;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision,
   to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
   b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
   c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal controls over financial reporting, to the registrant's auditors and audit committee of the registrant's board of directors (or persons performing the equivalent function);

   a) all significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 1, 2007

/s/ Margaret A. Torres
Margaret A. Torres
Chief Financial Officer

Exhibit 32.1

HERITAGE OAKS BANCORP

Annual Report on Form 10K
for the Year ended December 31, 2006

CERTIFICATION

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

The undersigned, who is the Chief Executive Officer of Heritage Oaks Bancorp (the “Company”), hereby certifies, pursuant to 18 USC Section 1350, that (i) the Annual Report on Form 10K for the year ended December 31, 2006, as filed by the Company with the Securities and Exchange Commission (the “Annual Report”), to which this Certification is an Exhibit, fully complies with the applicable requirements of Section 13(a) or 15(d) of the Exchange Act; and (ii) the information contained in this Annual Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: March 1, 2007

/s/ Lawrence P. Ward
Lawrence P. Ward,
President and Chief Executive Officer

Exhibit 32.2

HERITAGE OAKS BANCORP

Annual Report on Form 10K
for the Year ended December 31, 2006

CERTIFICATION

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

The undersigned, who is the Chief Financial Officer of Heritage Oaks Bancorp (the "Company"), hereby certifies, pursuant to 18 USC Section 1350, that (i) the Annual Report on Form 10K for the year ended December 31, 2006, as filed by the Company with the Securities and Exchange Commission (the "Annual Report"), to which this Certification is an Exhibit, fully complies with the applicable requirements of Section 13(a) or 15(d) of the Exchange Act; and (ii) the information contained in this Annual Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: March 1, 2007

/s/ Margaret A. Torres
Margaret A. Torres
Executive Vice President and Chief Financial Officer