Bank of Marin Bancorp
Form 10-K
March 15, 2010

BANK OF MARIN BANCORP

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

FORM 10-K

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

For the fiscal year ended: December 31, 2009
or

o 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: 001-33572

Bank of Marin Bancorp
(Exact name of Registrant as specified in its charter)

California (State or other jurisdiction of incorporation)	20-8859754 (IRS Employer Identification No.)
504 Redwood Blvd., Suite 100, Novato, CA (Address of principal executive office)	94947 (Zip Code)

(415) 763-4520
(Registrant's telephone number, including area code)

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

None

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

Common Stock, No Par Value, and attached Share Purchase Rights (Title of each class)	NASDAQ Capital Market (Name of each exchange on which registered)

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

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

Note – checking the box above will not relieve any registrant required to file reports pursuant to section 13 or 15(d) of the Exchange Act from their obligations under these sections.

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or 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 o	Accelerated filer x
Non-accelerated filer o	Smaller reporting company o

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

As of June 30, 2009, the last business day of the registrant's most recently completed second fiscal quarter, the aggregate market value of the voting and non-voting common equity held by non-affiliates, based upon the closing price per share of the registrant's common stock as reported by the NASDAQ, was approximately $135 million. For the purpose of this response, directors and officers of the Registrant are considered the affiliates at that date.

As of February 28, 2010 there were 5,235,077 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Proxy Statement for the Annual Meeting of Shareholders to be held on May 11, 2010 are incorporated by reference into Part III.

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Explanatory Note

Bank of Marin Bancorp is the successor registrant to Bank of Marin pursuant to an 8-K filed with the SEC on June 29, 2007.

On July 1, 2007 (the "Effective Date"), a bank holding company reorganization was completed whereby Bank of Marin Bancorp became the parent holding company for Bank of Marin. On the Effective Date, each outstanding share of Bank of Marin common stock was converted into one share of Bank of Marin Bancorp common stock and Bank of Marin became a wholly-owned subsidiary of the holding company. Bank of Marin Bancorp assumed the ticker symbol BMRC, which was formerly used by Bank of Marin. Prior to the Effective Date, Bank of Marin filed reports and proxy statements with the Federal Deposit Insurance Corporation ("FDIC") pursuant to Sections 12 of the Securities Exchange Act of 1934 (the "1934 Act").

References in this report to "Bancorp" mean the Bank of Marin Bancorp parent holding company for Bank of Marin (the "Bank"). References to "we," "our," "us" mean the holding company and the Bank that are consolidated for financial reporting purposes.

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

Copies of our filings are available by requesting them in writing or by phone from:

Corporate Secretary
Bank of Marin
504 Redwood Blvd., Suite 100
Novato, CA 94947
415-763-4523

They are also available on our website at www.bankofmarin.com. This website address is for information only and is not intended to be an active link, or to incorporate any website information into this document.

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PART I

Forward-Looking Statements

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

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

Forward-looking statements are based on Management's current expectations regarding economic, legislative, and regulatory issues that may impact our earnings in future periods. A number of factors - many of which are beyond Management's control - could cause future results to vary materially from current Management's expectations. Such factors include, but are not limited to, general economic conditions, the current financial turmoil in the United States and abroad, changes in interest rates, deposit flows, real estate values and competition; changes in accounting principles, policies or guidelines; changes in legislation or regulation; and other economic, competitive, governmental, regulatory and technological factors affecting our operations, pricing, products and services. These and other important factors are detailed in Item 1A Risk Factors section of this report. Forward-looking statements speak only as of the date they are made. We do not undertake to update forward-looking statements to reflect circumstances or events that occur after the date the forward-looking statements are made or to reflect the occurrence of unanticipated events.

ITEM 1. BUSINESS

On July 1, 2007, a bank holding company reorganization was completed whereby Bank of Marin Bancorp became the parent holding company for Bank of Marin (the "Bank"), its sole subsidiary. Upon formation of the holding company, Bancorp became subject to regulation under the Bank Holding Company Act of 1956, as amended, which subjects Bancorp to Federal Reserve Board reporting and examination requirements. The Bank was incorporated in August 1989, received its charter from the California Superintendent of Banks (now the California Department of Financial Institutions or "DFI") and commenced operations in January 1990. The Bank is an insured bank under the Federal Deposit Insurance Act.

Virtually all of our business is conducted through Bancorp's sole subsidiary, the Bank, which is headquartered in Novato, California. We operate through thirteen branch offices in Marin and southern Sonoma counties, north of San Francisco, California. We also have a commercial loan production office in San Francisco. Our customer base is made up of business and personal banking relationships from the communities near the branch office locations. Our business banking focus is on small to medium-sized businesses, professionals and not-for-profit organizations.

We offer a broad range of commercial and retail deposit and lending programs designed to meet the needs of our target markets. Our loan products include commercial loans and lines of credit, construction financing, consumer loans, and home equity lines of credit. Merchant card services are available for our customers in retail businesses. Through a third party vendor, we offer a proprietary Visa® credit card product combined with a rewards program to our customers, as well as a Business Visa® program for business and professional customers. We also offer cash management sweep to business clients through a third party vendor.

We offer a variety of personal and business checking and savings accounts, and a number of time deposit alternatives, including time certificates of deposit, Individual Retirement Accounts ("IRAs"), Health Savings Accounts, and Certificate of Deposit Account Registry Service ("CDARS®"). CDARS® is a network through which we offer full FDIC insurance coverage in excess of the regulatory maximum by placing deposits in multiple banks participating in the network. We also offer remote deposit capture, direct deposit of payroll, social security and pension checks, fraud prevention services, and image lockbox services. A valet deposit pick-up service is available to our professional and business clients. Automatic teller machines ("ATM's") are available at each branch location and at the Marin Airporter terminal in Larkspur.

Our ATM network is linked to the Cirrus, PLUS and NYCE networks. In January 2009, we began offering free access to a network of nation-wide surcharge-free ATM's called MoneyPass. We also offer our depositors 24-hour access to their accounts by telephone and through our internet banking products available to personal and business account holders.

We offer Wealth Management Services ("WMS") which include customized investment portfolio management, financial planning, trust administration, estate settlement and custody services, and advice of charitable giving. We also offer 401(k) plan services to small and medium businesses through a third party vendor.

We offer branch-based Private Banking as a natural extension of our services. Our Private Banking includes deposit services and loans, as well as a full range of banking services.

We do not directly offer international banking services, but do make such services available to our customers through other financial institutions with whom we have correspondent banking relationships.

We hold no patents, licenses (other than licenses required by the appropriate banking regulatory agencies), franchises or concessions. The Bank has registered the service marks "The Spirit of Marin", the words "Bank of Marin", the Bank of Marin logo, and the Bank of Marin tagline "Committed to your business and our community" with the United States Patent & Trademark Office. In addition, Bancorp has registered the service marks for the words "Bank of Marin Bancorp" and for the Bank of Marin Bancorp logo with the United States Patent & Trademark Office.

All service marks registered by Bancorp or the Bank are registered on the United States Patent & Trademark Office Principal Register, with the exception of the words "Bank of Marin Bancorp" which is registered on the United States Patent & Trademark Office Supplemental Register.

Market Area

Our primary market area reaches from southern Sonoma County to and including San Francisco and lies between the Pacific Ocean on the west and San Francisco Bay to the east. Our customer base is made up of business and personal banking relationships from the communities near the branch office locations.

We attract deposit relationships from individuals, merchants, small to medium-sized businesses, not-for-profit organizations and professionals who live and/or work in the communities comprising our market areas. Approximately 87% of our deposits are from Marin and southern Sonoma counties, and approximately 60% of our deposits are from businesses and 40% are from individuals.

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Competition

The banking business in California generally, and in our market area specifically, is highly competitive with respect to attracting both loan and deposit relationships. The increasingly competitive environment is impacted by changes in regulation, interest rate environment, technology and product delivery systems, and the consolidation among financial service providers. The Marin County market area is dominated by two major national banks, each of which has more branch offices than us in the defined service area. Additionally, there are several thrifts, including the major thrift institutions operating in the California market, credit unions and other independent banks.

Approximately 87 banking offices with $8.5 billion in total deposits as of June 30, 2009 served the Marin County market. As of that same date, there were approximately 4 thrift offices in Marin with $0.7 billion in total deposits. We have the largest business core deposit market share, representing 24.5% of business core deposits in Marin County[1]. We have also gained overall deposit market share in our primary market area in 2009[1]. The four financial institutions with the greatest deposit market share in Marin County are Wells Fargo Bank, Bank of America, Bank of Marin, and Westamerica Bank with deposit market shares of 25.1% and 18.9%, 9.4%, and 8.0%, respectively[1].

In the southern Sonoma County area of Petaluma, there are approximately 27 banking and thrift offices with $1.4 billion in total deposits as of June 30, 2009. Compared with our share of 3.9%, the four banking institutions with the greatest overall market share, Wells Fargo Bank, Bank of America, First Community Bank, and Bank of the West had deposit market shares in Petaluma of 32.1%, 16.7%, 9.0%, and 9.0%, respectively[1].

We also compete for depositors' funds with money market mutual funds and with non-bank financial institutions such as brokerage firms and insurance companies. Among the competitive advantages held by some of these non-bank financial institutions is their ability to finance extensive advertising campaigns, and to allocate investment assets to regions of California or other states with areas of highest demand and often, therefore, higher yield.

Nationwide banks have the competitive advantages of national advertising campaigns and technology infrastructure to achieve economies of scale. Large commercial banks also have substantially greater lending limits and have the ability to offer certain services which are not offered directly by us.

In order to compete with the numerous, and often larger, financial institutions in our primary market area, we use, to the fullest extent possible, the flexibility and rapid response capabilities which are accorded by our independent status. Our competitive advantages also include an emphasis on specialized services, community involvement, philanthropic giving, local promotional activities and personal contacts. The commitment and dedication of our organizers, directors, officers and staff have also contributed greatly to our success in competing for business.

Employees

At December 31, 2009, we employed 199 full-time equivalent ("FTE") staff. The actual number of employees at year-end 2009 included 5 executive officers, 72 other corporate officers and 145 staff. None of our employees are presently represented by a union or covered by a collective bargaining agreement. We believe that our employee relations are good. We have been recognized as one of the "Best Places to Work in the San Francisco Bay Area" by the San Francisco Business Times.

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1 Based on the latest available FDIC deposit market share data as of June 30, 2009.

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SUPERVISION AND REGULATION

Bank holding companies and banks are extensively regulated under both federal and state law. The following discussion summarizes certain significant laws, rules and regulations affecting Bancorp and the Bank.

Bank Holding Company Regulation

Upon formation of the bank holding company on July 1, 2007, we became subject to regulation under the Bank Holding Company Act of 1956, as amended ("BHCA") which subjects Bancorp to Federal Reserve Board reporting and examination requirements. Under the Federal Reserve Board's regulations, a bank holding company is required to serve as a source of financial and managerial strength to its subsidiary banks.

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

Bank Regulation

Banking regulations are primarily intended to protect depositors' funds, federal deposit insurance funds and the banking system as a whole. These regulations affect our lending practices, consumer protections, capital structure, investment practices and dividend policy.

As a state chartered bank, we are subject to regulation and examination by the DFI. We are also subject to regulation, supervision and periodic examination by the FDIC. If, as a result of an examination of the Bank, the FDIC or the DFI should determine that the financial condition, capital resources, asset quality, earnings prospects, management, liquidity, or other aspects of our operations are unsatisfactory or that we have violated any law or regulation, various remedies are available to those regulators including restricting our growth or removing officers and directors.

Dividends

The payment of cash dividends by the Bank to Bancorp is subject to restrictions set forth in the California Financial Code (the "Code"). Prior to any distribution from the Bank to Bancorp, a calculation is made to ensure compliance with the provisions of the Code and to ensure that the Bank remains within capital guidelines set forth by the DFI and the FDIC. As the Bank made a $28 million distribution to Bancorp in March 2009 in connection with Bancorp's repurchase of preferred stock discussed in Note 9 to the Consolidated Financial Statements in Item 8 of this report, distributions from the Bank to Bancorp will be subject to advance regulatory approval from the DFI for three years beginning in 2010. Management anticipates that there will be sufficient earnings at the Bank level to provide dividends to Bancorp to meet its funding requirements for the foreseeable future. See also Note 9 to the Consolidated Financial Statements, under the heading "Dividends" in Item 8 of this report.

FDIC Insurance Assessments

Our deposits are insured by the FDIC to the maximum amount permitted by law which is currently $250,000 per depositor through December 31, 2013. On January 1, 2014, the standard insurance amount will return to $100,000 per depositor for all account categories except for IRAs and other certain retirement accounts which will remain at $250,000 per depositor. On October 14, 2008, the FDIC announced the Temporary Transaction Account Guarantee Program to strengthen confidence in the banking system. The rule, as amended, also allows full deposit insurance coverage for non-interest bearing transaction accounts regardless of the dollar amount until June 30, 2010 at the participating FDIC-insured institutions' option. We have elected to participate in the program by paying a 10 basis point surcharge on the non-interest bearing transaction accounts over $250,000 through December 31, 2009, and a 15 basis point surcharge through June 30, 2010. Effective April 1, 2009, the FDIC adopted a final rule revising its risk-based insurance assessment system and effectively increasing the overall assessment rate. The new base assessment rates for banks in the best risk category range from twelve to sixteen cents annually for every $100 of domestic deposits held. In addition, the FDIC also imposed a special Deposit Insurance assessment of five basis points on all insured institutions' total assets minus Tier 1 capital at June 30, 2009 in order to replenish the Deposit Insurance Fund.

On November 12, 2009, the FDIC finalized a Deposit Insurance Fund restoration plan that required banks to prepay, on December 30, 2009, their estimated quarterly risk-based assessments for the fourth quarter of 2009 and for all of 2010, 2011 and 2012. Under the plan, banks are assessed through 2010 according to the risk-based premium schedule adopted in April 2009. However, beginning January 1, 2011, the base rate increases by three basis points per year.

Community Reinvestment Act

We are subject to the provisions of the Community Reinvestment Act ("CRA"), under which all banks and thrifts have a continuing and affirmative obligation, consistent with safe and sound operations, to help meet the credit needs of their entire communities, including low and moderate income neighborhoods. The act requires a depository institution's primary federal regulator, in connection with its examination of the institution, to assess the institution's record in meeting the requirements in CRA. The regulatory agency's assessment of the institution's record is made available to the public. The record is taken into consideration when the institution establishes a new branch that accepts deposits, relocates an office or applies to merge or consolidate, or expand into other activities. CRA performance is evaluated by the FDIC under the intermediate small bank requirements. The FDIC's last CRA and consumer compliance examination performed on us was completed on May 7, 2009 with a rating of "Satisfactory."

Anti-Money Laundering Regulations

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

Privacy and Data Security

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

Consumer Protection Regulations

Our lending activities are subject to a variety of statutes and regulations designed to protect consumers, including the Fair Credit Reporting Act, Equal Credit Opportunity Act, the Fair Housing Act, and the Truth-in-Lending Act. Our deposit operations are also subject to laws and regulations that protect consumer rights including Funds Availability, Truth in Savings, and Electronic Funds Transfers. Additional rules govern check writing ability on certain interest earning accounts and prescribe procedures for complying with administrative subpoenas of financial records. Additionally, the provision of the Federal Reserve Regulation E has been changed effective July 1, 2010. It puts restrictions on institutions assessing overdraft fees on consumer's accounts relating to electronic funds transfers. As a result, our deposit fee income may be impacted.

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The following discussion summarizes certain significant laws, rules and regulations affecting both Bancorp and the Bank.

Restriction on Transactions between Member Banks and their Affiliates

Transactions between Bancorp and the Bank are quantitatively and qualitatively restricted under Sections 23A and 23B of the Federal Reserve Act and Federal Reserve Regulation W. Section 23A places restrictions on the Bank's "covered transactions" with Bancorp, including loans and other extensions of credit, investments in the securities of, and purchases of assets from Bancorp. Section 23B requires that certain transactions, including all covered transactions, be on market terms and conditions. Federal Reserve Regulation W combines statutory restrictions on transactions between the Bank and Bancorp with Board interpretations in an effort to simplify compliance with Sections 23A and 23B.

Capital Requirements

The Federal Reserve and the FDIC have adopted risk-based capital guidelines for bank holding companies and banks. Banks are classified as either well capitalized, adequately capitalized or undercapitalized. Holding companies are classified as either adequately capitalized or under capitalized. Bancorp meets the definition of adequately capitalized and the Bank meets the definition for well capitalized. Undercapitalized depository institutions may be subject to significant restrictions. Payment of interest and principal on subordinated debt of the Bank could be restricted or prohibited, with some exceptions, if the Bank were categorized as "critically undercapitalized" under applicable FDIC regulations. For further information on risk-based capital, see Note 16 to the Consolidated Financial Statements in Item 8 of this Form 10-K.

Sarbanes-Oxley Act of 2002

We are subject to the requirements of the Sarbanes-Oxley Act of 2002 which implemented legislative reforms intended to address corporate and accounting improprieties.

Emergency Economic Stabilization Act of 2009 (the "EESA")

In response to the financial crisis affecting the banking system and financial markets and going concern threats of investment banks and other financial institutions, on October 3, 2008, the EESA was signed into law, which gave the U.S. Treasury the authority to, among other things, inject $700 billion capital into the market to stabilize the financial industry. Pursuant to the EESA, the U.S. Treasury also purchased senior preferred shares from the largest nine financial institutions in the nation and the other financial institutions in a program known as the Treasury Capital Purchase Program ("TCPP") that was carved out of the Troubled Asset Relief Program ("TARP"). As a result of our participation in the TCPP, we were subject to restrictions on executive compensation and limitations on dividends and stock repurchases from December 5, 2008 to March 31, 2009, the period that the preferred stock issued to the U.S. Treasury was outstanding.

The American Recovery and Reinvestment Act of 2009 (the "Recovery Act")

The Recovery Act was signed into law on February 17th, 2009 in an effort, among other things, to jumpstart the U.S. economy, prevent job losses, expand educational opportunities, and provide affordable health care and tax relief. Among the various measures in the Recovery Act, it imposes further restriction on executive compensation and corporate expenditure limits of recipients of the TCPP funds, while allowing them to repurchase the preferred stock at liquidation amount without regard to the original TCPP transaction terms. See Note 9 to the Consolidated Financial

Statements in Item 8 of this report for discussion regarding our repurchase of preferred stock issued under the TCPP.

Future Legislation and Regulatory Initiatives

Various other legislative and regulatory initiatives, including proposals to overhaul the banking regulatory system are from time to time introduced in Congress and state legislatures, as well as regulatory agencies. Currently, the Congress is actively considering significant changes to the manner of regulating financial institutions including combining one or more of the FRB, FDIC, Comptroller of the Currency and the Office of Thrift Supervision and creating a new consumer protection agency for financial products. The current legislation being consider and other future legislation regarding financial institutions may change banking statutes and the operating environment of Bancorp and the Bank in substantial and unpredictable ways, and could increase or decrease the cost of doing business, limit or expand permissible activities or affect the competitive balance depending upon whether any of this potential legislation will be enacted, and if enacted, the effect that it or any implementing regulations, would have on the financial condition or results of operations of Bancorp or the Bank. The nature and extent of future legislative and regulatory changes affecting financial institutions is unpredictable at this time. We cannot determine the ultimate effect that such potential legislation, if enacted, would have upon our financial condition or operations.

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Available Information

On our internet web site, www.bankofmarin.com, we post the following filings as soon as reasonably practicable after they are filed with or furnished to the SEC: Annual Report on Form 10-K, Proxy Statement for the Annual Meeting of Shareholders, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities and Exchange Act of 1934. The text of the Code of Ethical Conduct for Bancorp and the Bank is also included on the website. All such filings on our site are available free of charge. No information from the website is deemed to be incorporated herein.

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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, investors should carefully consider the risks and uncertainties described below together with all of the other information included or incorporated by reference in this 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 business operations. This 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.

Our Earnings are Significantly Affected by General Business and Economic Conditions

We are operating in a challenging and uncertain economic environment. While the economic recession waned in 2009, recent data on jobs, retail sales, housing starts and manufacturing have been less than encouraging. The volatility of the equity markets and the U.S. budget deficit underline that the economy remains very vulnerable to further deterioration. Economic recovery, if any, is expected to be slow and long amid a bleak job market. Business activity across a wide range of industries and regions is greatly affected. Local and state governments are in difficulty due to the reduction in sales taxes resulting from the lack of consumer spending and property taxes resulting from declining property values. Financial institutions continue to be affected by the contraction of the real estate market, elevated foreclosure rates, increased unemployment rates and a stricter regulatory environment. While our service area has not experienced the same degree of challenge as other areas2, the full effect of these issues on our nation's economy, commercial and consumer markets, and ultimately, our business is not fully known at this time.

Continued declines in real estate values and home sale volumes, financial stress on borrowers, including job losses, and customers' inability to pay debt could adversely affect our financial condition and results of operations in the following aspects:

- Demand for our products and services may decline
- Low cost or non-interest bearing deposits may decrease
- Collateral for our loans, especially real estate, may decline further in value
- Loan delinquencies, problem assets and foreclosures may increase

Our deposit growth level has outpaced our loan growth recently, which leads to excess liquidity earning a less favorable yield. As the economy is still fragile, consumers are wary of their debts and are reducing their borrowing activities. We have noticed a decrease in loan demand due to an unfavorable economic climate and intensified competition for creditworthy borrowers, all of which could impact our ability to generate profitable loans.

Recently Enacted Legislation and Other Measures Undertaken by the Government May not Help Stabilize the U.S. Financial System and the Current Volatile Market

As discussed in Item 1, Section captioned "Bank Regulation" above, on February 17, 2009, President Obama signed into law the Recovery Act, more commonly known as the "Stimulus Bill". The Stimulus Bill includes a wide variety of programs intended to stimulate the economy and provide for extensive infrastructure, energy, health and education needs. In addition, the Stimulus Bill imposes certain new executive compensation and corporate expenditure limits on all current and future TARP recipients.

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2 Based on the latest available labor market information from Employment Development Department. Preliminary December 2009 results show that the unemployment rate in Marin County was the lowest in California at 7.8% and in Sonoma County at 10.1%, compared to the state of California at 12.1%.

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The actual impact of the Stimulus Bill and such related measures undertaken to alleviate the aftermaths of the credit crisis is unknown. The failure of such measures to help stabilize the financial markets and a continuation or worsening of current financial market conditions could adversely affect our business, financial condition, results of operations, and access to credit. The capital and credit markets have experienced volatility and disruption at an unprecedented level. In some cases, the markets have produced downward pressure on credit availability for certain issuers without regard to those issuers' underlying financial strength. If current levels of market disruption and volatility continue or worsen, there can be no assurance that we will not experience an adverse effect on our ability to access credit or capital.

Negative Conditions Affecting Real Estate May Harm Our Business

Concentration of our lending activities in the California real estate sector could negatively impact our results of operations if the adverse changes in the real estate market in our lending area intensify. Although we do not offer traditional first mortgages, nor have sub-prime or Alt-A residential loans or significant amount of securities backed by such loans in the portfolio, we are not immune from the effect of the set-back of the real estate market. Approximately 86% of our loans were secured by real estate at December 31, 2009, of which 64% were secured by commercial real estate and the remaining 22% by residential real estate. Real estate valuations are impacted by demand, and demand is driven by factors such as employment; when unemployment rises, demand falls off. The unemployment rate has increased steadily, from 5.5% in December 2008 to 7.8% in December 2009 in Marin County. Therefore, the value of the real estate loan collateral may continue to decline in the real estate market in which we conduct our business. Most of the properties that secure our loans are located within Marin and Sonoma Counties. In 2009, the median residential home values fell 18% in Marin County and 12% in Sonoma County.

Loans secured by commercial real estate include those secured by small office buildings, owner-user office/warehouses, mixed-use residential/commercial properties and retail properties. In 2009, office vacancy rate in Marin County has risen from 14.5% to 26.3%3, while industrial and retail have held relative steady at generally low vacancy rates. In Sonoma County, vacancy rates are generally higher than in Marin County: the rate of industrial, retail, and office vacancies increased from 12.8%, 6.5%, and 20.5% in 2008 to 15.5%3, 9.2%3,and 24.8%3 in 2009, respectively. There can be no assurance that the companies or properties securing our loans will generate sufficient cash flows to allow the borrowers to make full and timely loan payments to us.

In late 2006, Federal banking regulators issued final guidance regarding commercial real estate lending to address a concern that rising commercial real estate lending concentrations may expose institutions to unanticipated earnings and capital volatility in the event of adverse changes in the investor commercial real estate market. 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. Although regulators have not notified us of any concern, there is no assurance that we will not be subject to additional scrutiny in the future.

We are Subject to Interest Rate Risk

Our earnings and cash flows are largely dependent upon our net interest income. Net interest income is the difference between interest income earned on interest-earning assets, such as loans and securities, and interest expense paid on interest-bearing liabilities, such as deposits and borrowed funds. Interest rates are sensitive to many factors outside our control, including general economic conditions and policies of various governmental and regulatory agencies and, in particular, the Board of Governors of the Federal Reserve System, which regulates the supply of money and credit in the United States. Changes in monetary policy, including changes in interest rates, could influence not only the interest we receive on loans and securities and interest we pay on deposits and borrowings, but could also affect (i) our ability to originate loans and obtain deposits, (ii) the fair value of our financial assets and liabilities, and (iii) the average duration of our mortgage-backed securities portfolio. Our portfolio of securities is subject to interest rate risk and will generally decline in value if market interest rates increase, and generally increase in value if market interest rates decline. Our mortgage-backed security portfolio is also subject to prepayment risk in a low interest rate environment.

3 Based on the latest available real estate information from Keegan & Coppin Company, Inc.

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In response to the recessionary state of the national economy, the gloomy housing market and the volatility of financial markets, the Federal Open Market Committee of the Federal Reserve Board ("FOMC") started a series of decreases in Federal funds target rate with seven decreases in 2008, bringing the target rate to a historically low range of 0% to 0.25% through December of 2009. In the current environment of historically low short-term interest rates, it is imperative for us to mitigate exposure to potential increases in interest rates. If interest rates rise, we anticipate that net interest income will rise which may be partially offset by deposit rate sensitivity. In addition, it may take several upward market rate movements for variable rate loans at floors to move above their floor rates.

Interest rate changes can create fluctuations in the net interest margin due to an imbalance in the timing of repricing or maturity of assets or liabilities. We manage interest rate risk exposure with the goal of minimizing the impact of interest rate volatility on the net interest margin. Although we believe we have implemented effective asset and liability management strategies, any substantial, prolonged low interest rate environment could have an adverse effect on our financial condition and results of operations. See the sections captioned "Net Interest Income" in Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 7 and Quantitative and Qualitative Disclosures about Market Risk in Item 7A of this report for further discussion related to management of interest rate risk.

Loan Losses May Exceed Our Allowance for Loan Losses in the Future

We maintain an allowance for loan losses, which is a reserve established through a provision for loan losses charged to expense, that represents Management's best estimate of probable losses that may be incurred within the existing portfolio of loans. The level of the allowance reflects Management's continuing evaluation of industry concentrations, specific credit risks, loan loss experience, current loan portfolio quality and present economic, political and regulatory conditions. The determination of the appropriate level of the allowance for loan losses inherently involves a high degree of subjectivity and requires us to make significant estimates of current credit risks and future trends, all of which may undergo material changes. Further, we generally rely on appraisals of the collateral or comparable sales data to determine the level of specific reserve and/or the charge-off amount on certain collateral dependent loans. Inaccurate assumptions in the appraisals or an inappropriate choice of the valuation techniques may lead to inadequate level of specific reserve or charge-offs.

Changes in economic conditions affecting borrowers, new information regarding existing loans, identification of additional problem loans and other factors, may require an increase in our allowance for loan losses. In addition, bank regulatory agencies periodically review our allowance for loan losses and may require an increase in the provision for loan losses or the recognition of further loan charge-offs. In addition, if charge-offs in future periods exceed the allowance for loan losses, we will need to record additional loan loss provisions. Any increases in the allowance for loan losses will result in an adverse impact on net income and capital.

We Face Intense Competition for Deposits with Other Financial Instruments

In 2010, we may see tighter competition in the industry as banks seek to take market share in the most profitable customer segments, particularly the small business segment and the mass-affluent segment, which offers a rich source of deposits as well as more profitable and less risky customer relationships. Further, with the rebound of the equity markets, our deposit customers may perceive alternative investment opportunities as providing superior expected returns. Technology and other changes have made it more convenient for bank customers to transfer funds into alternative investments or other deposit accounts such as online virtual banks and non-bank service providers. The current low interest rate environment could increase such transfers of deposits to higher yielding deposits or other investments. Efforts and initiatives we undertake to retain and increase deposits, including deposit pricing, can increase our costs. When our customers move money into higher yielding deposits or in favor of alternative investments, we can lose a relatively inexpensive source of funds, thus increasing our funding costs.

In addition, in current market conditions, certain depositors are wary of placing funds in financial institutions irrespective of the temporary increase in FDIC insurance to $250,000 per customer as evidenced by a strong demand for U.S. Treasury securities in the wake of bank failures. We also compete with national banks much larger than our size, which may be able to benefit from economies of scale through their wider branch network, national advertising campaigns and sophisticated technology infrastructure.

We intend to seek additional deposits by continuing to establish and strengthen our personal relationships with our existing customers and by offering deposit products that are competitive with those offered by other financial institutions in our markets. If these efforts are unsuccessful, we may need to fund our asset growth through borrowings, other non-core funding or public offerings of our common stock which could be leveraged. Increased debt would further increase our leverage, reduce our borrowing capacity and increase our reliance on non-core funds and counterparties' credit availability. A public offering would have a dilutive effect on earnings per share and share ownership.

Our Ability to Access Markets for Funding and Acquire and Retain Customers could be Adversely Affected by the Deterioration of Other Financial Institutions or the Financial Service Industry's Reputation.

Reputation risk is the risk to liquidity, earnings and capital arising from negative publicity regarding the financial services industry. The financial services industry continues to be featured in negative headlines about the global and national credit crisis and the resulting stabilization legislation enacted by the U.S. federal government. These reports can be damaging to the industry's image and potentially erode consumer confidence in insured financial institutions. Recent bank failures in California have had a negative impact and additional failures are expected. In addition, our ability to engage in routine funding and other transactions could be adversely affected by the actions and commercial soundness of other financial institutions. Financial services institutions are interrelated as a result of trading, clearing, counterparty or other relationships. As a result, defaults by, or even rumors or questions about, one or more financial services institutions, or the financial services industry generally, have led to market-wide liquidity problems, losses of depositor, creditor and counterparty confidence and could lead to losses or defaults by us or by other institutions. We could experience increases in deposits and assets as a direct or indirect result of other banks' difficulties or failure, which would increase the capital we need to support such growth or we could experience severe and unexpected decreases in deposits which could adversely impacts our liquidity and heighten regulatory concern.

Bancorp and the Bank are Subject to Extensive Government Regulation and Supervision

Bancorp and the Bank are subject to extensive federal and state governmental supervision, regulation and control. Holding company regulations affect the range of activities in which Bancorp is engaged. Banking regulations affect the Bank's lending practices, capital structure, investment practices and dividend policy among other controls. Future legislative changes or interpretations may also alter the structure and competitive relationship among financial institutions.

The historic disruptions in the financial marketplace over the past few years have prompted the Obama administration to reform financial market regulation. This proposed reform includes additional regulations over consumer financial products, bond rating agencies and the creation of a regime for regulating systemic risk across all types of financial service firms. In light of recent economic conditions as well as regulatory and congressional criticism, further restrictions on financial service companies may adversely impact our results of operations and financial condition, as well as increase our compliance risk.

Compliance risk is the current and prospective risk to earnings or capital arising from violations of, or nonconformance with, laws, rules, regulations, prescribed practices, internal policies, and procedures, or ethical standards set forth by regulators. Compliance risk also arises in situations where the laws or rules governing certain bank products or activities of our clients may be ambiguous or untested. This risk exposes Bancorp and the Bank to potential fines, civil money penalties, payment of damages and the voiding of contracts. Compliance risk can lead to diminished reputation, reduced franchise value, limited business opportunities, reduced expansion potential and an inability to enforce contracts.

For further information on supervision and regulation, see the section captioned "Supervision and Regulation" in Item 1 above.

Bancorp Relies on Dividends from the Bank to Pay Cash Dividends to Shareholders

Bancorp is a separate legal entity from its subsidiary, the Bank. Bancorp receives all of its revenue from the Bank in the form of dividends, which is Bancorp's principal source of funds to pay cash dividends to Bancorp's common shareholders. Various federal and state laws and regulations limit the amount of dividends that the Bank may pay to Bancorp. In the event that the Bank is unable to pay dividends to Bancorp, Bancorp may not be able to pay dividends to its shareholders. As a result, it could have an adverse effect on Bancorp's stock price and investment value.

Under federal law, capital distributions from the Bank would become prohibited, with limited exceptions, if the Bank were categorized as "undercapitalized" under applicable Federal Reserve or FDIC regulations. In addition, as a California bank, the Bank is subject to state law restrictions on the payment of dividends. Distributions from the Bank to Bancorp will be subject to advance regulatory approval for three years beginning in 2010. For further information on the distribution limit from the Bank to Bancorp, see the section captioned "Bank Regulation" in Item 1 above and "Dividends" in Note 9 to the Consolidated Financial Statements in Item 8 below.

The Trading Volume of Bancorp's Common Stock is Less than That of Other Larger Financial Services Companies

Our common stock is listed on the NASDAQ's Capital Market. Our trading volume is less than that of other national financial institutions. A public trading market having the desired characteristics of depth, liquidity and orderliness depends on the presence of willing buyers and sellers of 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 trades of our stock in a given time, or the expectations of these trades, could cause the stock price to be more volatile.

Failure of Correspondent Banks and Counterparties May Affect our Liquidity

In the past few years, the financial services industry in general was materially and adversely affected by the credit crises. We have witnessed failure of banks in the industry in recent years and the trend is expected to continue in 2010. We rely on our correspondent banks for lines of credit. We also have two correspondent banks as counterparties in our derivative transactions (see Note 15 to the Consolidated Financial Statements). While we continually monitor the financial health of our correspondent banks and we have diverse sources of liquidity, should any one of our correspondent banks become financially impaired, our available credit may decline and/or they may be unable to honor their commitments.

Unexpected Early Termination of Our Interest Rate Swap Agreements May Impact Our Earnings

We have entered into interest-rate swap agreements, primarily as an asset/liability management strategy, in order to mitigate the changes in the fair value of specified long-term fixed-rate loans and firm commitments to enter into long-term fixed-rate loans caused by changes in interest rates. These hedges allow us to offer long-term fixed rate loans to customers without assuming the interest rate risk of a long-term asset by swapping our fixed-rate interest stream for a floating-rate interest stream. In the event of default by the borrowers on our hedged loans, we may have to terminate these designated interest-rate swap agreements early, resulting in severe prepayment penalties charged by our counterparties. On the other hand, when these interest-rate swap agreements are in an asset position, we are subject to the credit risk of our counterparties, who may default on the interest-rate swap agreements, leaving us vulnerable to interest rate movements.

Securities May Lose Value due to Credit Quality of the Issuers

We hold approximately $62.5 million in securities issued and/or guaranteed by Federal National Mortgage Association ("FNMA") and Federal Home Loan Mortgage Corporation ("FHLMC") at December 31, 2009. In 2008, the U.S. Government placed both FNMA and FHLMC under conservatorship. Besides making available up to $100 billion for injection into the preferred equity (senior to the current preferred equity) of FNMA and FHLMC, the U.S. Treasury established a new secured lending credit facility available to both FNMA and FHLMC. Starting in December 2008, the U.S. Government also began purchasing mortgage-backed securities ("MBS") issued by FNMA. Further, in December 2009, the U.S. Treasury also announced unlimited capital support for FNMA and FHLMC for the next three years. As a result, the MBS issued by FNMA and FHLMC has experienced an increase in fair value and our available-for-sale security portfolio has benefitted from this government support. However, in its January 2010 meeting, the FOMC highlighted its commitment to end the MBS purchase program by the end of March of 2010, and said it will look to end other emergency liquidity programs when they are no longer needed. If the government support is withdrawn and either the FNMA or FHLMC comes under further financial stress or deteriorates in their credit worthiness, the fair value of our securities issued or guaranteed by these entities could be negatively affected.

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At December 31, 2009, we also hold $30.4 million in obligations of state and political subdivisions, some of which are experiencing financial difficulties in part due to loss of property tax from falling home values and decline in sales tax revenues from reduction in retail activities. While we seek to minimize our exposure by diversifying geographic location of our portfolio and investing in investment grade securities, there is no guarantee that the issuers will remain financially sound to be current with their payments on these debentures.

Further, we are required to maintain a certain level of investment in the Federal Home Loan Bank of San Francisco ("FHLB") through the purchase of stock, which is bought from and sold to the FHLB at $100 par. Both stock and cash dividends may be received on FHLB stock. Recently, the FHLB announced that in order to preserve capital, they are temporarily suspending stock repurchases. This has raised concern as to the FHLB's ability to redeem capital stock as they face increasing regulation on their required level of capital.

Deterioration of Credit Quality or Insolvency of Insurance Companies May Impede our Ability to Recover Losses

The recent financial crisis has led certain major insurance companies to the verge of bankruptcy. We have property, casualty and financial institution risk coverage underwritten by several insurance companies, who may not avoid the insolvency risk permeated in the insurance industry. While we closely monitor credit ratings of our insurers and are poised to make quick changes if needed, we cannot predict an unexpected inability to honor commitments. We also invest in bank-owned life insurance policies on certain members of senior management, which may lose value in the event of the carriers' insolvency. In the event that our bank-owned life insurance policy carriers' credit ratings fall below investment grade, we may exchange policies underwritten by them to another carrier at a cost charged by the original carrier, or we may terminate the policies which may result in adverse tax consequences.

Our loan portfolios are also secured by properties located in earthquake or fire-prone zones. In the event of a disaster that causes pervasive damage to the region in which we operate, not only the Bank, but also the loan collateral may suffer losses not recovered by insurance.

We May Experience a Breach in Security

Our business requires the secure handling of sensitive client information. A breach of security in the Bank, at our vendors or customers, or widely publicized breaches of other financial institutions could significantly harm 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. While we have systems and procedures designed to prevent security breaches, we cannot be certain that advances in criminal capabilities, physical system or network break-ins or inappropriate access will not compromise or breach the technology protecting our networks or proprietary client information.

We Rely on Third-Party Vendors for Important Aspects of Our Operation

We depend on the accuracy and completeness of information provided by certain key vendors, including but not limited to, data processing, payroll processing, technology supports, investment security safekeeping and accounting. Our ability to operate, as well as the our financial condition and results of operations, could be negatively affected in the event of interruptions of information systems, an undetected error, or in the event of a natural disaster whereby certain vendors are unable to maintain business continuity.

Severe Weather, Natural Disasters or Other Climate Change Related Matters Could Significantly Impact Our Business

Our primary market is located in an earthquake-prone zone in northern California. Other severe weather or disasters, such as severe rainstorms, wildfire or flood, could interrupt our business operation unexpectedly. Climate-related physical changes and hazards could also pose credit risks for us. For example, our borrowers may have collateral properties located in coastal areas at risk to rise in sea level. The properties pledged as collateral on our loan portfolio could also be damaged by tsunamis, floods, earthquake or wildfires and thereby the recoverability of our loan could be impaired. A number of factors affect our credit losses, including the extent of damage to the collateral, the extent of damage not covered by insurance, the extent to which unemployment and other economic conditions caused by the natural disaster adversely affect the ability of borrowers to repay their loans, and the cost of collection and foreclosure to us. Lastly, there could be increased insurance premiums and deductibles, or a decrease in the availability of coverage, due to severe weather-related losses. The ultimate impact on our business of a natural disaster, whether or not caused by climate change, is difficult to predict.

Effort to Replenish the FDIC Insurance Fund Would Impact Our Financial Results and Business.

As financial institutions continue to fail, the FDIC Deposit Insurance Fund ("DIF") is depleting rapidly. In 2009, the FDIC adopted a rule which authorizes the FDIC to impose up to two five basis-point special assessments. In addition, on November 12, 2009, the FDIC finalized a Deposit Insurance Fund restoration plan that required banks to prepay, on December 30, 2009, their estimated quarterly assessments for the fourth quarter of 2009 and for all of 2010, 2011 and 2012.The FDIC is also looking at other options to rebuild the DIF, including borrowing funds from healthy banks, tapping into the U.S. Treasury lines of credit, and/or imposing another special assessment. If the FDIC does choose to impose another special assessment, it could have a significant impact on our operating expenses. As part of the new budget, the U.S. government also proposed increasing the DIF reserve ratio target over 1.50% (up from the current 1.15% to 1.50% range) and included a provision that would impose a 15 basis-point tax on the largest banks. If the DIF falls below a level adequate to cover costs associated with bank failures, additional assessments and/or higher rates could be imposed, which would have a negative impact on our results of operations and financial condition.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

We lease our corporate headquarters building, which houses our primary loan production, operations, and administrative offices, in Novato, California. We also lease other branch or office facilities within our primary market areas in the cities of Petaluma, Novato, San Rafael, Corte Madera, Greenbrae, Mill Valley, Sausalito, and San Francisco, California. We consider our properties to be suitable and adequate for our present needs. For additional information on properties, see Notes 5 and 13 to the Consolidated Financial Statements included in Item 8 of this Form 10-K.

ITEM 3. LEGAL PROCEEDINGS

There are no pending, or to Management's knowledge any threatened, material legal proceedings to which we are a party, or to which any of our properties are subject. There are no material legal proceedings to which any director, any nominee for election as a director, any executive officer, or any associate of any such director, nominee or officer is a party adverse to us.

We are responsible for our proportionate share of certain litigation indemnifications provided to Visa U.S.A. by its member banks in connection with lawsuits related to anti-trust charges and interchange fees. For further details, see Note 13 to the Consolidated Financial Statements in Item 8 of this Form 10-K.

ITEM 4. REMOVED AND RESERVED

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PART II

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

Bancorp common stock trades on the NASDAQ Capital Market under the symbol BMRC.

At February 28, 2010, 5,235,077 shares of Bancorp's common stock, no par value, were outstanding and held by approximately 2,603 holders of record. The following table sets forth, for the periods indicated, the range of high and low sales prices of Bancorp's common stock. The prices have been adjusted to reflect the effect of all stock dividends and stock splits.

Quarter/Year	High	Low
4th Quarter 2009	$ 35.75	$ 30.20
3rd Quarter 2009	$ 33.81	$ 26.55
2nd Quarter 2009	$ 29.25	$ 21.10
1st Quarter 2009	$ 24.44	$ 17.01
4th Quarter 2008	$ 33.00	$ 23.00
3rd Quarter 2008	$ 33.60	$ 24.10
2nd Quarter 2008	$ 29.99	$ 24.00
1st Quarter 2008	$ 31.00	$ 26.90

The table below shows cash dividends paid to common shareholders on a quarterly basis in the last two fiscal years.

	2009		2008	
	Per Share	Dollars	Per Share	Dollars
1Q	$ 0.14	$ 722,000	$ 0.14	$ 721,000
2Q	$ 0.14	$ 724,000	$ 0.14	$ 721,000
3Q	$ 0.14	$ 730,000	$ 0.14	$ 720,000
4Q	$ 0.15	$ 784,000	$ 0.14	$ 720,000

For additional information regarding our ability to pay dividends, see discussion in Note 9 to the Consolidated Financial Statement, under the heading "Dividends," in Item 8 of this report.

In November 2007, Bancorp's Board of Directors approved a plan to repurchase common shares of Bancorp up to $5 million. No regulatory approval was required for this repurchase plan as Bancorp was exempted under the provisions of Regulation Y of the Federal Reserve Board. In November and December of 2007, Bancorp repurchased a total of 51,732 shares at an average price of $29.96 per share for a total cost of $1.5 million. During the first nine months of 2008, Bancorp repurchased 88,316 shares at an average price of $28.55, plus commissions, for a total cost of $2.5 million. In September 2008, the repurchases under the plan were discontinued to preserve capital during a time of extreme economic turbulence.

There were no purchases made by or on behalf of Bancorp or any "affiliated purchaser" (as defined in Rule 10b-18(a)(3) under the Securities Exchange Act of 1934), of the Bancorp's common stock during the fourth quarter of 2009.

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Securities Authorized for Issuance under Equity Compensation Plans

The following table summarizes information as of December 31, 2009, with respect to equity compensation plans. All plans have been approved by the shareholders.

	(A) Shares to be issued upon exercise of outstanding options		(B) Weighted average exercise price of outstanding options	(C) Shares available for future issuance (Excluding shares in column A)
Equity compensation plans approved by shareholders	359,795	(1)	$ 27.54	381,805

(1) Represents shares of common stock issuable upon exercise of outstanding options under the Bank of Marin 1990 Stock Option Plan, the Bank of Marin 1999 Stock Option Plan and the Bank of Marin Bancorp 2007 Equity Plan.

Stock Price Performance Graph

The following graph, provided by Keefe, Bruyette, & Woods, Inc., shows a comparison of cumulative total shareholder return on ticker symbol BMRC common stock during the five fiscal years ended December 31, 2009 compared to Russell 2000 Stock index and peer group index of other financial institutions. We changed the benchmark index from Standard & Poors 500 used in prior years to Russell 2000 since we are now part of this small-cap index. The comparison assumes $100 was invested on December 31, 2004 in BMRC common stock and all of the dividends were reinvested. The performance graph represents past performance and should not be considered to be an indication of future performance. Ticker symbol BMRC represents the common stock of Bank of Marin Bancorp subsequent to its formation July 1, 2007 and represents the common stock of Bank of Marin for periods prior to the formation of the bank holding company.

	2004	2005	2006	2007	2008	2009
BMRC	100	92	102	83	68	92
Peer Group*	100	120	136	102	51	32
Russell 2000	100	106	126	124	82	104

*BMRC Peer Group represents public California banks with assets between $750 million to $1.5 million as of December 31, 2009: AMBZ, BOCH, BBNK, CVCY, FCAL, HTBK, HEOP, NOVB, PMBC, PPBI, PFBC, RCBC, BSRR. The peer group composite index is weighted by market capitalization and reinvests dividends on the ex-date and adjusts for stock splits, if applicable.

Source: Company Reports, FactSet, and SNL

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ITEM 6. SELECTED FINANCIAL DATA

As of For the Year Ended December 31, (Dollars in thousands, except per share data)	2009		2008		2007		2006		2005		2008/2009 % change	
At December 31												
Total assets	$1,121,672		$1,049,557		$933,901		$876,578		$840,449		6.9	%
Total loans	917,748		890,544		724,878		719,778		686,661		3.1	%
Total deposits	944,061		852,290		834,642		736,697		721,172		10.8	%
Total stockholders' equity1	109,051		125,546		87,774		89,525		78,221		-13.1	%
Equity-to-asset ratio	9.7	%	12.0	%	9.4	%	10.2	%	9.3	%	-18.7	%
For year ended December 31												
Net interest income	$52,567		$48,359		$42,742		$41,733		$39,442		8.7	%
Provision for loan losses	5,510		5,010		685		1,266		1,541		10.0	%
Non-interest income	5,182		5,356		5,718		3,972		3,708		-3.2	%
Non-interest expense	31,696		28,677		27,673		25,891		22,498		10.5	%
Net income	12,765		12,150		12,324		11,883		11,737		5.1	%
Net income per share (diluted) 2	2.19		2.31		2.31		2.11		2.12		-5.2	%
Cash dividend payout ratio on common stock 3	25.8	%	23.9	%	21.4	%	20.8	%	8.4	%	7.9	%

1 The Bank’s capital has declined from December 31, 2008 to December 31, 2009 due to dividends by the Bank to Bancorp of $28.0 million to fund Bancorp’s repurchase of preferred stock, as well as $9.8 million to cover Bancorp’s operational needs and cash dividends to shareholders for the near future.

2 Restated for all stock dividends and stock splits.

3 Calculated as dividends on common share divided by basic net income per common share.

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

The following discussion of financial condition as of December 31, 2009 and 2008 and results of operations for each of the years in the three-year period ended December 31, 2009 should be read in conjunction with our consolidated financial statements and related notes thereto, included in Part II Item 8 of this report. Average balances, including balances used in calculating certain financial ratios, are generally comprised of average daily balances.

Forward-Looking Statements

The disclosures set forth in this item are qualified by important factors detailed in Part I captioned Forward-Looking Statements and Item 1A captioned Risk Factors of this report and other cautionary statements set forth elsewhere in the report.

Executive Summary

We produced healthy financial results in 2009 with record annual earnings of $12.8 million for the year, an increase of $615 thousand, or 5.1%, from 2008. Our continued focus on responsible community banking fundamentals and our strong customer relationships has led to this solid earnings growth, as well as higher deposits, a core funding source for our steady loan growth. Deposit growth in 2009 was substantial at $91.8 million, or 10.8%, without compromising our pricing discipline. Non-interest bearing deposits totaled 24.4% of total deposits at December 31, 2009, an increase from 23.6% a year ago. We have also expanded our franchise by opening a branch in Greenbrae, California in September 2009.

Diluted earnings per share were $2.19 for the year 2009, compared to $2.31 for the year 2008. 2009 diluted earnings per share were reduced by $0.25 related to Bancorp's participation and withdrawal from the TCPP and $0.06 related to an FDIC special assessment, respectively, as discussed later.

We are committed to actively lend with a focus in our local community. Total loans reached $917.7 million at the end of 2009, representing growth of $27.2 million, or a 3.1% increase from the end of prior year. The mix of loans reflects an increase in home equity lines of credit and a decrease in construction loans as a percentage of total loans.

Our focus on prudent lending standards and active management of loans have kept our loan losses to a manageable level. Non-accrual loans at December 31, 2009 totaled $11.6 million, or 1.26% of Bancorp's loan portfolio at December 31, 2009 compared to $6.7 million or 0.75% a year ago. Accruing loans past due 30 to 89 days declined to $835 thousand at December 31, 2009 from $4.4 million at December 31, 2008. Net charge-offs totaled $4.8 million in 2009 compared to $2.6 million in 2008. The charge-offs in 2009 primarily relate to commercial and construction loans secured by real property where the value of collateral has declined. Recovery of the losses, if any, will depend on the value of the collateral when the property is sold. Net loans charged off in 2009 represent 0.53% of average loans compared to 0.33% in 2008. The provision for loan losses totaled $5.5 million in 2009 compared to $5.0 million in 2008. The allowance for loan losses of $10.6 million totaled 1.16% of loans and 91.8% of non-accrual loans at December 31, 2009, compared to 1.12% and 148.7% respectively a year ago.

On March 31, 2009, Bancorp repurchased all 28,000 shares of outstanding preferred stock issued in December 2008 under the TCPP program. We determined that continued participation in the TCPP was not in the best interests of our common shareholders, customers or our employees, and it would impede our ability to compete after the U.S government's actions, interpretations, and commentary regarding various aspects of the TCPP program. The warrant issued to the U.S. Treasury to purchase 154,242 shares of our common stock remains outstanding. The U.S. Treasury expects to sell the warrant through auction.

After the repurchase of the preferred stock under the TCPP, we continued to grow our capital during 2009. The total risk-based capital ratio for Bancorp at December 31, 2009 totaled 12.3%, exceeding industry standards for being well-capitalized.

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Our tax-equivalent net interest margin was robust at 5.17% in 2009. It decreased twenty-four basis points from 5.41% in 2008 in a declining rate environment. In December 2008, the FOMC brought the target interest rate to a historic low with a range of 0% to 0.25% where it remained as of December 31, 2009. Decreases in the tax-equivalent net interest margin were primarily due to the downward re-pricing of the Bank's loan portfolio in a declining rate environment as well as maturities and pay downs of loans with higher yields, and to a lesser extent, interest foregone on non-accrual loans (representing a seven basis-point and a two basis-point reduction to the net interest margin in 2009 and 2008, respectively).

The largest factors likely to affect our net interest margin in 2010 will be our ability to generate loans, an increase in the Federal funds target rate, which is expected to rise in late 2010, as well as our responsiveness to competitive pricing on loans and deposits in our market. In the current environment of historically low short-term interest rates, it is imperative for us to mitigate exposure to potential increases in interest rates. If interest rates rise, we anticipate that net interest income will rise. The increase in interest income from asset repricing may be partially offset by deposit rate sensitivity. In addition, it may take several upward market rate movements for variable rate loans at floors to move above the floor rates. Further, we have noticed a decrease in loan demand due to an unfavorable economic climate and intensified competition for creditworthy borrowers, all of which could impact our ability to generate profitable loans.

Our efficiency ratio increased from 53.39% in 2008 to 54.89% in 2009. The increase reflected a $496 thousand special assessment imposed by the FDIC of five basis points on total assets minus Tier 1 capital in the second quarter of 2009. The increase also reflects a higher FDIC insurance assessment rate, higher personnel and occupancy costs associated with branch expansion, operational losses, increased legal fees in connection with our participation and termination in the TCPP program, as well as legal fees associated with loans.

Holding Company

On May 8, 2007, shareholders of the Bank approved the formation of a bank holding company. On July 1, 2007, the holding company, Bank of Marin Bancorp, acquired the Bank as its wholly owned subsidiary. The holding company is expected to provide flexibility in meeting our financing needs and in responding to evolving changes in the banking and financial services industries.

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

Critical Accounting Policies

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

Management has determined the following five accounting policies to be critical: Allowance for Loan Losses, Other-than-temporary Impairment of Investment Securities, Share-Based Payment, Accounting for Income Taxes and Fair Value Measurements.

Allowance for Loan Losses

Allowance for loan losses is based upon estimates of loan losses and is maintained at a level considered adequate to provide for probable losses inherent in the outstanding loan portfolio. The allowance is increased by provisions charged to expense and reduced by net charge-offs. In periodic evaluations of the adequacy of the allowance balance, Management considers our past loan loss experience by type of credit, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, current economic conditions and other factors. We formally assess the adequacy of the allowance for loan losses on a quarterly basis. These assessments include the periodic re-grading of loans based on changes in their individual credit characteristics including delinquency, seasoning, recent financial performance of the borrower, economic factors, changes in the interest rate environment, and other factors as warranted. Loans are initially graded when originated. They are reviewed as they are renewed, when there is a new loan to the same borrower and/or when identified facts demonstrate heightened risk of default. Confirmation of the quality of our grading process is obtained by independent reviews conducted by outside consultants specifically hired for this purpose and by periodic examination by various bank regulatory agencies. Management monitors delinquent loans continuously and identifies problem loans to be evaluated individually for impairment testing. For loans that are determined impaired, formal impairment measurement is performed at least quarterly on a loan-by-loan basis.

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Our method for assessing the appropriateness of the allowance includes specific allowances for identified problem loans, an allowance factor for categories of credits, and allowances for changing environmental factors (e.g., portfolio trends, concentration of credit, growth, economic factors). Allowances for identified problem loans are based on specific analysis of individual credits. Loss estimation factors for loan categories are based on analysis of local economic factors applicable to each loan category. Allowances for changing environmental factors are Management's best estimate of the probable impact these changes have had on the loan portfolio as a whole.

Other-than-temporary Impairment of Investment Securities

At each financial statement date, we assess whether declines in the fair value of held-to-maturity and available-for-sale securities below their costs are deemed to be other than temporary. We consider, among other things, (i) the length of time and the extent to which the fair value has been less than cost, (ii) the financial condition and near-term prospects of the issuer, and (iii) our intent and ability to retain the investment for a period of time sufficient to allow for any anticipated recovery in fair value. Evidence evaluated includes, but is not limited to, the remaining payment terms of the instrument and economic factors that are relevant to the collectability of the instrument, such as: current prepayment speeds, the current financial condition of the issuer(s), industry analyst reports, credit ratings, credit default rates, interest rate trends and the value of any underlying collateral. Credit-related other-than-temporary-impairment results in a charge to earnings and the corresponding establishment of a new cost basis for the security. Non-credit-related other-than-temporary impairment results in a charge to other comprehensive income, net of applicable taxes, and the corresponding establishment of a new cost basis for the security. The other-than-temporary impairment recognized in other comprehensive income for debt securities classified as held-to-maturity is accreted from other comprehensive income to the amortized cost of the debt security over the remaining life of the debt security in a prospective manner on the basis of the amount and timing of future estimated cash flows.

Share-Based Payment

We recognize all share-based payments, including stock options and non-vested restricted common shares, as an expense in the income statement based on the grant-date fair value of the award with a corresponding increase to common stock.

We determine the fair value of stock options at the grant date using the Black-Scholes pricing model that takes into account the stock price at the grant date, the exercise price, the expected dividend yield, stock price volatility and the risk-free interest rate over the expected life of the option. The Black-Scholes model requires the input of highly subjective assumptions, including the expected life of the stock-based award (derived from historical data on employee exercise and post-vesting employment termination behavior) and stock price volatility (based on the historical volatility of the common stock). The estimates used in the model involve inherent uncertainties and the application of Management's judgment. As a result, if other assumptions had been used, our recorded stock-based compensation expense could have been materially different from that reflected in these financial statements. The fair value of non-vested restricted common shares generally equals the stock price at grant date. In addition, we are required to estimate the expected forfeiture rate and only recognize expense for those share-based awards expected to vest. If our actual forfeiture rate is materially different from the estimate, the share-based compensation expense could be materially different.

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Accounting for Income Taxes

Income taxes reported in the financial statements are computed based on an asset and liability approach. We recognize the amount of taxes payable or refundable for the current year, and deferred tax assets and liabilities for the expected future tax consequences that have been recognized in the financial statements. Under this method, deferred tax assets and liabilities are determined based on the differences between the financial statements and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. We record net deferred tax assets to the extent it is more likely than not that they will be realized. In evaluating our ability to recover the deferred tax assets, Management considers all available positive and negative evidence, including scheduled reversals of deferred tax liabilities, projected future taxable income, tax planning strategies and recent financial operations. In projecting future taxable income, Management develops assumptions including the amount of future state and federal pretax operating income, the reversal of temporary differences, and the implementation of feasible and prudent tax planning strategies. These assumptions require significant judgment about the forecasts of future taxable income and are consistent with the plans and estimates being used to manage the underlying business. Bancorp files consolidated federal and combined state income tax returns.

We recognize the financial statement effect of a tax position when it is more likely than not, based on the technical merits, that the position will be sustained upon examination. For tax positions that meet the more-likely-than-not threshold, we may recognize only the largest amount of tax benefit that is greater than fifty percent likely of being realized upon ultimate settlement with the taxing authority. Management believes that all of our tax positions taken meet the more-likely-than-not recognition threshold. To the extent tax authorities disagree with these tax positions, our effective tax rates could be materially affected in the period of settlement with the taxing authorities.

Fair Value Measurements

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

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

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RESULTS OF OPERATIONS

Overview

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

(Dollars in thousands, except per share data)	As of and for the years ended December 31, 2009	2008	2007
For the period:			
Net income	$12,765	$12,150	$12,324
Net income per share			
Basic	$2.21	$2.34	$2.38
Diluted	$2.19	$2.31	$2.31
Return on average equity	11.46 %	12.73 %	14.44 %
Return on average common equity	10.94 %	12.88 %	14.44 %
Return on average assets	1.16 %	1.28 %	1.38 %
Common stock dividend payout ratio	25.79 %	23.93 %	21.43 %
Efficiency ratio	54.89 %	53.39 %	57.10 %
At period end:			
Book value per common share	$20.85	$19.14	$17.13
Total assets	$1,121,672	$1,049,557	$933,901
Total loans	$917,748	$890,554	$724,878
Total deposits	$944,061	$852,290	$834,642
Loan-to-deposit ratio	97.21 %	104.49 %	86.85 %

Summary of Quarterly Results of Operations

Table 1 sets forth the quarterly results of operations for 2009 and 2008:

Table 1 Summarized Statement of Operations

	2009 Quarters Ended				2008 Quarters Ended			
(Dollars in thousands)	Dec. 31	Sept. 30	Jun. 30	Mar. 31	Dec. 31	Sept. 30	Jun. 30	Mar. 31
Interest income	$15,204	$15,116	$14,837	$14,577	$15,063	$15,028	$14,544	$14,541
Interest expense	1,814	1,780	1,804	1,769	2,214	2,717	2,635	3,251
Net interest income	13,390	13,336	13,033	12,808	12,849	12,311	11,909	11,290
Provision for loan losses	2,525	1,100	700	1,185	2,200	1,685	510	615
Net interest income after provision for loan losses	10,865	12,236	12,333	11,623	10,649	10,626	11,399	10,675
Non-interest income	1,341	1,331	1,273	1,237	1,181	1,194	1,279	1,702
Non-interest expense	7,763	7,776	8,600	7,557	7,094	7,442	7,140	7,001
Income before provision for income taxes	4,443	5,791	5,006	5,303	4,736	4,378	5,538	5,376
	1,641	2,190	1,873	2,074	1,943	1,683	2,152	2,100

Provision for income taxes								
Net income	$2,802	$3,601	$3,133	$3,229	$2,793	$2,695	$3,386	$3,276
Preferred stock dividends and accretion	---	---	---	$(1,299)	$(113)	---	---	---
Net income available to common shareholders	$2,802	$3,601	$3,133	$1,930	$2,680	$2,695	$3,386	$3,276
Net income per common share								
Basic	$0.53	$0.69	$0.61	$0.38	$0.52	$0.53	$0.66	$0.64
Diluted	$0.52	$0.68	$0.60	$0.37	$0.52	$0.52	$0.65	$0.63

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Net Interest Income

Net interest income is the difference between the interest earned on loans, investments and other interest-earning assets and the interest expense incurred on deposits and other interest-bearing liabilities. Net interest income is impacted by changes in general market interest rates and by changes in the amounts and composition of interest-earning assets and interest-bearing liabilities. Interest rate changes can create fluctuations in the net interest margin due to an imbalance in the timing of repricing or maturity of assets or liabilities. We manage interest rate risk exposure with the goal of minimizing the impact of interest rate volatility on net interest margin.

Net interest margin is expressed as net interest income divided by average interest-earning assets. Net interest rate spread is the difference between the average rate earned on total interest-earning assets and the average rate incurred on total interest-bearing liabilities. Both of these measures are reported on a taxable-equivalent basis. Net interest margin is the higher of the two because it reflects interest income earned on assets funded with non-interest-bearing sources of funds, which include demand deposits and stockholders' equity.

Table 2, Distribution of Average Statements of Condition and Analysis of Net Interest Income, compares interest income and average interest-earning assets with interest expense and average interest-bearing liabilities for the three years 2009, 2008 and 2007. The table also indicates net interest income, net interest margin and net interest rate spread for each period presented.

Table 2 Distribution of Average Statements of Condition and Analysis of Net Interest Income

	2009			2008			2007		
(Dollars in thousands)	Average Balance	Interest Income/ Expense	Yield/ Rate	Average Balance	Interest Income/ Expense	Yield/ Rate	Average Balance	Interest Income/ Expense	Yield/ Rate
Assets									
Federal funds sold and other short-term investments	$ 1,916	$ 5	0.26 %	$ 4,212	$ 138	3.22 %	$ 42,584	$ 2,209	5.19 %
Investment securities									
U.S. Treasury securities (1)	---	---	---	---	---	---	315	8	2.43
U.S. Government agencies (1)	70,268	3,304	4.70	72,606	3,555	4.90	75,775	3,759	4.96
Corporate debt securities and other (1)	7,397	506	6.84	6,124	273	4.46	11,110	656	5.92
Obligations of state and political subdivisions (2)	29,221	1,677	5.74	19,541	1,106	5.66	13,067	641	4.91
Loans and banker's acceptances (2) (3) (4)	910,456	55,071	5.97	798,369	54,475	6.82	703,087	54,730	7.78

Total interest-earning assets (4)	1,019,258	60,563	5.86	900,852	59,547	6.61	845,938	62,003	7.33
Cash and due from banks	46,594			21,990			24,364		
Bank premises and equipment, net	8,140			8,354			8,185		
Interest receivable and other assets, net	26,041			17,325			16,301		
Total assets	$ 1,100,033			$ 948,521			$ 894,788		
Liabilities and Stockholders' Equity									
Interest-bearing transaction accounts	$ 90,159	$ 115	0.13 %	$ 78,672	$ 344	0.44 %	$ 76,673	$ 301	0.39 %
Savings and money market accounts	437,515	3,329	0.76	430,621	6,910	1.60	414,592	14,161	3.42
CDARS® time deposits	51,248	721	1.41	9,039	200	2.21	---	---	---
Other time accounts	97,924	1,541	1.57	83,735	2,466	2.95	86,268	3,465	4.02
Purchased funds	64,453	1,281	1.99	30,069	601	2.00	16,097	765	4.76
Subordinated debenture (4)	5,000	180	3.55	5,000	296	5.92	5,000	407	8.14
Total interest-bearing liabilities	746,299	7,167	0.96	637,136	10,817	1.70	598,630	19,099	3.19
Demand accounts	232,502			208,320			204,146		
Interest payable and other liabilities	9,873			7,624			6,648		
Stockholders' equity	111,359			95,441			85,364		
Total liabilities & stockholders' equity	$ 1,100,033			$ 948,521			$ 894,788		
Tax-equivalent net interest income/margin (4)		$ 53,396	5.17 %		$ 48,730	5.41 %		$ 42,904	5.07 %
Reported net interest income/margin (4)		$ 52,567	5.09 %		$ 48,359	5.37 %		$ 42,742	5.05 %
Tax-equivalent net interest rate spread			4.90 %			4.91 %			4.14 %

(1) Yields on available-for-sale securities are calculated based on amortized cost balances rather than fair value, as changes in fair value are reflected as a component of stockholders' equity.

(2) Yields and interest income on tax-exempt securities and loans are presented on a taxable-equivalent basis using the Federal statutory rate of 35 percent.
(3) Average balances on loans outstanding include non-performing loans, if any. The amortized portion of net loan origination fees is included in interest income on loans, representing an adjustment to the yield.
(4) Interest income/expense is divided by actual number of days in the period times 360 days to correspond to stated interest rate terms, where applicable.

The tax-equivalent net interest margin decreased to 5.17% in 2009, down twenty-four basis points from 2008. The decrease in the net interest margin was primarily due to the repricing of our loan portfolio in a declining rate environment, and to a lesser extent, interest foregone on non-accrual loans (representing a seven-basis-point impact on the net interest margin in 2009 versus a two-basis-point effect in 2008). In 2008, the effect on the net interest margin of lower rates on deposits and borrowings due to sharply declining market rates outweighed the effect of lower asset yields, resulting in a thirty-four basis point increase to the margin.

The net interest rate spread in 2009 is consistent with 2008, reflecting a decrease of seventy-five basis points in the yield on interest-earning assets and a decline of seventy-four basis points in the cost of interest-bearing liabilities. In 2008, the yield on interest-earning assets declined seventy-two basis points while the yield on interest-earning liabilities declined dramatically by 149 basis points, reflecting a sharply declining interest rate environment. Market rate changes have a more immediate effect on deposit rates than on loan yields due to our fixed-rate loans (see Table 10 below for our fixed vs. variable loans distribution). In addition, the large majority of our variable loans are tied to the U.S. Treasury Constant Maturity Indices with repricing intervals between one year to five years.

Market rates are in part based on the Federal Reserve Open Market Committee ("FOMC") target Federal funds interest rate (the interest rate banks charge each other for short-term borrowings). The change in the Federal funds sold and purchased rates is the result of target rate changes implemented by the FOMC. In 2008, there were seven downward adjustments to the target rate totaling 325 basis points, bringing the target interest rate to a historic low with a range of 0% to 0.25% where it remained as of December 2009.

The overall earnings on assets are affected by loan rates and the mix of interest-earning assets. Average interest-earning assets increased $118.4 million, or 13.1%, in 2009 compared to 2008. The increase primarily relates to average loan growth of $112.1 million and an increase in average investment securities of $8.6 million, partially offset by a $2.3 million decline in average Federal funds sold. There was no significant shift in the mix of interest-earning assets in 2009. The composition of interest-earning assets in 2008 compared to 2007 reflects a shift to higher-yielding loans from Federal funds sold. The movement followed the sale of the indirect auto portfolio in the second quarter of 2007 when the proceeds of $76 million were initially invested in Federal funds sold and gradually reinvested in higher-yielding relationship loans.

The yield on the loan portfolio, which comprised approximately 89% of average earning assets in 2009 and 2008, decreased eighty-five basis points in 2009 and ninety-six basis points in 2008 due to the downward repricing of variable-rate loans and new loans originated at lower market rates, as well as maturities and pay downs of higher yielding loans.

The yield on agency securities in 2009 decreased twenty basis points from 2008, mainly reflecting a tighter spread between agency yields and Treasury rates on newly purchased agency securities due to the stabilization of the MBS market in 2009 and increased prepayments of higher-yielding securities which accelerated the amortization of premiums. The yield on agency securities in 2008 decreased six basis points from 2007 mainly due to a lower interest rate environment. The yield on municipal bonds increased eight basis points in 2009 and seventy-five basis points in 2008, as the yields on securities purchased were impacted by state and political subdivisions which were forced to offer higher rates when investors were wary of the credit quality of the issuer and the insurance companies who guaranteed the instruments.

The overall cost of liabilities is affected by offered rates and the mix of deposits and other liabilities. The overall rate on interest-bearing liabilities decreased seventy-four basis points in 2009 over 2008. The rate on savings and money market accounts, CDARS®, and time deposits decreased 84 basis points, 80 basis points, and 138 basis points, respectively, in 2009 compared to 2008, reflecting lower offered rates on deposits in response to lower market rates.

The rate on purchased funds remained essentially unchanged in 2009 due to unchanged Federal funds target rate and our procurement of fixed-rate FHLB advances in 2008 and early 2009. The rate on purchased funds decreased 276 basis points in 2008 over 2007, primarily due to declines in the Federal funds target rate. The rate on the subordinated debenture declined 237 basis points in 2009 and 222 basis points in 2008 due to a decline in the three-month LIBOR rate, to which the debenture rate is indexed.

The average balance of interest-bearing liabilities increased $109.2 million, or 17.1%, in 2009 compared to 2008. The increases are pervasive in all categories of interest-bearing liabilities, most notably in CDARS® deposits and purchased funds, which increased $42.2 million and $34.4 million respectively in 2009. Late in the first quarter of 2008, we began to offer a new deposit product, Certificate of Deposit Account Registry Service ("CDARS®"), a network through which the Bank offers FDIC insurance coverage in excess of the current $250 thousand regulatory maximum by placing deposits in multiple banks participating in the network. We have experienced a shift in the relative mix of interest-bearing liabilities in 2009 compared to 2008: the proportion of higher-costing liabilities (mainly CDARS® and purchased funds) has increased from 6.1% of interest-bearing liabilities in 2008 to 15.5% in 2009, while the proportion of money market deposit accounts has decreased from 61.3% in 2008 to 52.5% in 2009.

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The average balance of interest-bearing liabilities increased $38.5 million, or 6.4%, in 2008 over 2007, with increases recorded in most deposit categories. Notably, the increase in average savings and money market accounts of $16.0 million was mainly due to a new on-balance sheet cash sweep program. CDARS→ contributed to an increase in average deposits of $9.0 million. The increase in interest-bearing liabilities in 2008 was also the result of an increase in average purchased funds of $14.0 million as our loan growth outpaced the deposit growth in 2008.

Table 3, Analysis of Changes in Net Interest Income, separates the change in net interest income into two components: (1) volume – change caused by increases or decreases in the average asset and liability balances outstanding, and (2) yield/rate – changes in average yields on earning assets and average rates for interest-bearing liabilities.

Table 3 Analysis of Changes in Net Interest Income

	2009 compared to 2008			2008 compared to 2007		
(Dollars in thousands)	Volume	Yield/ Rate (1)	Total	Volume	Yield/ Rate (1)	Total
Assets						
Federal funds sold	$ (49)	$ (84)	$ (133)	$ (1,458)	$ (613)	$ (2,071)
Investment securities						
U. S. Treasury securities	---	---	---	(8)	---	(8)
U. S. government agencies	(112)	(139)	(251)	(155)	(49)	(204)
Obligations of state and political subdivisions	65	168	233	(247)	(136)	(383)
Municipal bonds (2)	556	15	571	355	110	465
Loans and bankers' acceptances (2)	7,521	(6,925)	596	6,938	(7,193)	(255)
Total interest-earning assets	7,981	(6,965)	1,016	5,425	(7,881)	(2,456)
Liabilities						
Interest-bearing transaction accounts	44	(273)	(229)	8	35	43
Savings and money market accounts	109	(3,690)	(3,581)	528	(7,779)	(7,251)
CDARS® deposits	619	(98)	521	200	---	200
Other time accounts	366	(1,291)	(925)	(99)	(900)	(999)
Purchased funds	683	(3)	680	434	(598)	(164)
Subordinated Debenture	---	(116)	(116)	---	(111)	(111)
Total interest-bearing liabilities	1,821	(5,471)	(3,650)	1,071	(9,353)	(8,282)
Tax-equivalent net Interest Income	$ 6,160	$ (1,494)	$ 4,666	$ 4,354	$ 1,472	$ 5,826

(1) The changes for each category of interest income and expense are divided between the portion of change attributable to the variance in volume and the portion of change attributable to the variance in rate for that category. The unallocated change in rate or volume variance has been allocated between the rate and volume variances on a pro

rata basis.
(2) Yields and interest income on tax-exempt securities and loans are presented on a taxable-equivalent basis using the Federal statutory rate of 35 percent.

The table indicates that in 2009, our net interest income was favorably affected by the increase in volume of interest-earning assets, which outweighed the effect of declines in yields. The decline in our asset yields in 2009 reflected our variable loans that repriced downward as their indexed rate reset. In 2008, the decreases in both interest income and interest expense were heavily impacted by rapid decreases in market rate, partially offset by increases related to volume.

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Provision for Loan Losses

Management assesses the adequacy of the allowance for loan losses on a quarterly basis based on several factors including growth of the loan portfolio, analysis of probable losses in the portfolio, recent loss experience and the current economic climate. Actual losses on loans are charged against the allowance, and the allowance is increased through the provision for loan losses charged to expense to bring the allowance to a level, based on Management's best judgment, to absorb probable losses inherent in the existing loan portfolio. For further discussion, see the section captioned "Critical Accounting Policies."

Our provision for loan losses totaled $5.5 million in 2009 compared to $5.0 million in 2008 and $685 thousand in 2007. The increase to the provision for loan losses from the prior years reflected recent losses on specifically-identified loans, increases in loan loss factors applied to certain types of loans as a result of the prevailing weaker economic conditions in recent years, as well as our loan growth. See the section captioned "Allowance for Loan Losses" below for further analysis of the provision for loan losses.

Non-interest Income

Non-interest income includes service charges on deposit accounts, WMS income and other income.

Table 4 Significant Components of Non-interest Income

(Dollars in thousands)	Year Ended December 31, 2009	2008	2007	2009 compared to 2008 Amount Increase (Decrease)	2009 compared to 2008 Percent Increase (Decrease)	2008 compared to 2007 Amount Increase (Decrease)	2008 compared to 2007 Percent Increase (Decrease)
Service charges on deposit accounts	$1,782	$1,654	$1,251	$128	7.7 %	$403	32.2 %
Wealth Management Services	1,383	1,292	1,229	91	7.0	63	5.1
Net gain on indirect auto and Visa portfolios	---	---	1,097	---	---	(1,097)	NM
Net gain on redemption of shares in Visa, Inc.	---	457	---	(457)	NM	457	NM
Other non-interest income							
Earnings on Bank owned life insurance	696	640	577	56	8.8	63	10.9
Customer banking fees and other charges	466	409	536	57	13.9	(127)	(23.7)
Other income	855	904	1,028	(49)	(5.4)	(124)	(12.1)
Total other non-interest income	2,017	1,953	2,141	64	3.3	(188)	(8.8)
Total non-interest income	$5,182	$5,356	$5,718	$(174)	(3.2 %)	$(362)	(6.3 %)

NM - Not Meaningful

In 2008, the mandatory redemption of a portion of our shares of Visa, Inc. generated a net gain of $457 thousand as discussed in Note 2 to Consolidated Financial Statements in Item 8 of this report. Excluding this nonrecurring gain, non-interest income in 2009 increased $283 thousand, or 5.8%, from 2008.

The increase in service charges on deposit accounts in 2009 was primarily due to the increase in the volume of deposit accounts. The increase in service charges on deposit accounts in 2008 was primarily attributable to an increase in fees from our business analysis accounts, primarily reflecting a reduced earnings credit, as well as an increase in fees on checks drawn against insufficient funds effective April 1, 2007, combined with a higher volume of rebounded checks.

The increase in WMS income in 2009 primarily reflected a higher level of assets under management. The increase in 2008 WMS income was primarily due to higher estate settlement and trustee fees, partially offset by market declines affecting fees.

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The increase in bank-owned life insurance ("BOLI") income is attributable to the full-year's worth of income earned on the $2.2 million of policies purchased in August 2008. The increase in customer banking fees in 2009 is primarily due to a $46k increase in Visa® debit fees attributable to a higher volume of Visa® card applications resulting from a promotion, as well as an increase in remote deposit capture fees. The decrease in other income in 2009 is primarily due to decreases of $164k of dividends on FHLB stock, and the absence of $42 thousand in interest we received in the second quarter of 2008 on amended tax returns, partially offset by $145k increase in net Merchant Card fee income due to lower interchange costs charged by our data processing vendor resulting from the renegotiation of our data processing contract.

The decrease in the other non-interest income in 2008 was primarily due to a $91 thousand decrease in reverse mortgage fees, an $83 thousand decrease in net remote deposit capture fees (which are offset by earnings credit through business analysis), a $65 thousand decrease in Visa® fees following the sale of the Visa® credit card portfolio in the third quarter of 2007, and a $48 thousand decrease in cash manager fees (when customers switched to a new on-balance sheet sweep product, we no longer receive significant fees from the previous cash management reserve processor). The decreases were partially offset by higher miscellaneous income due to $42 thousand of interest we received in the second quarter of 2008 on amended tax returns and a $63 thousand increase in BOLI income due to $2.2 million new purchase of policies in 2008.

The sale of the indirect auto loan portfolio generated a pre-tax net gain in 2007 of $710 thousand and the sale of the Visa® credit card portfolio generated a pre-tax net gain of $387 thousand in 2007, resulting in total net gains of $1.1 million.

Non-interest Expense

Table 5, Significant Components of Non-interest Expense, summarizes the amounts and changes in dollars and percentages. Our efficiency ratio (the ratio of non-interest expense divided by the sum of non-interest income and net interest income) totaled 54.89% in 2009, 53.39% in 2008 and 57.10% in 2007.

Table 5 Significant Components of Non-interest Expense

	Year Ended December 31,			2009 compared to 2008		2008 compared to 2007	
(Dollars in thousands)	2009	2008	2007	Amount Increase (Decrease)	Percent Increase (Decrease)	Amount Increase (Decrease)	Percent Increase (Decrease)
Salaries and related benefits	$ 17,001	$ 16,097	$ 15,900	$ 904	5.6 %	$ 197	1.2 %
Occupancy and equipment	3,516	3,202	2,871	314	9.8 %	331	11.5 %
Depreciation and amortization	1,370	1,340	1,246	30	2.2 %	94	7.5 %
FDIC Insurance	1,800	507	263	1,293	255.0 %	244	92.8 %
Data processing costs	1,650	1,825	1,657	(175)	(9.6 %)	168	10.1 %
Professional services	1,727	1,600	1,681	127	7.9 %	(81)	(4.8 %)
Other non-interest expense							
Advertising	528	439	297	89	20.3 %	142	47.8 %
Director expense	420	444	395	(24)	(5.4)%	49	12.4 %

Other expense	3,684	3,223	3,363	461	14.3 %	(140)	(4.2 %)
Total other non-interest expense	4,632	4,106	4,055	526	12.8 %	51	1.3 %
Total non-interest expense	$ 31,696	$ 28,677	$ 27,673	$ 3,019	10.5 %	$ 1,004	3.6 %

The increase in salaries and benefits in 2009 from the prior year primarily reflected annual merit increases, higher personnel costs associated with branch expansion, higher incentive compensation, as well as higher employee insurance. Average FTE totaled 195 and 190 during 2009 and 2008, respectively.

The increase in salaries and benefits in 2008 from the prior year primarily reflected higher salaries related to annual merit increases, and higher commissions and employee insurance. These increases were partially offset by a $179 thousand decrease in our contribution to Employee Stock Ownership and Savings Plan, a $74 thousand decrease in stock-based compensation and lower capitalization of deferred loan costs.

The increase in occupancy and equipment expenses in 2009 from 2008 was primarily related to higher premises rent associated with the new Greenbrae branch opened in September 2009 and increases for renewed leases, as well as a full year of rent for the Mill Valley branch opened in June 2008. The increase in occupancy and equipment expenses in 2008 compared to 2007 was primarily related to higher premises rent associated with the new Mill Valley branch and increases for renewed leases, as well as higher maintenance and repair costs.

Depreciation and amortization increased slightly in 2009 and reflected amortization of the recently capitalized leasehold improvements of the Greenbrae and Mill Valley branches, partially offset by the effect of certain assets that became fully-depreciated in 2009. The increase in depreciation and amortization expenses in 2008 was primarily due to the addition of leasehold improvements associated with the remodeling of the San Rafael branch in the second quarter of 2008, and the addition of the Mill Valley branch in June 2008.

The increase in FDIC insurance was due to a higher FDIC assessment rate (which more than doubled from last year), and higher deposits. Effective April 1, 2009, the FDIC adopted a final rule revising its risk-based insurance assessment system and effectively increasing the overall assessment rate. The new initial base assessment rates for Risk Category 1 institutions range from twelve to sixteen basis points, on an annualized basis. The FDIC also imposed a special deposit insurance assessment of five basis points on all insured institutions' total assets minus Tier 1 capital at June 30, 2009 in order to replenish the Deposit Insurance Fund. As a result, we recognized $496 thousand from this special assessment in 2009. The increase of FDIC insurance in 2008 over 2007 is primarily due to an increase in the industry-wide FDIC assessment rate and growth in our deposit level. In addition, in November 2008, we elected to participate in the FDIC Transaction Account Guarantee Program, which provides unlimited insurance coverage on non-interest-bearing transaction accounts defined by the FDIC, on which we will pay a 10 basis point surcharge per $100 covered balances in excess of $250 thousand through 2009. The 10 basis point surcharge on non-interest-bearing transaction accounts over $250 thousand will increase to 15 basis points from January to June 2010, at which time the program expires.

Data processing costs decreased in 2009 over 2008 as we benefitted from the renegotiation of our contract with our data processing vendor. The increase in data processing costs in 2008 over 2007 reflected a one-time de-conversion cost that related to credit card customers, as well as one-time costs associated with network upgrades, set-up of our new cash manager sweep program, and the related training costs.

The increase in professional services in 2009 over 2008 was primarily due to an increase in legal expenses relating to the repurchase of preferred shares as well as legal expenses relating to delinquent loans. These increases were partially offset by decreases in other professional fees associated with the discontinuation of a consulting agreement that began in July of 2006 and ended in June of 2008. The decrease in professional services in 2008 over 2007 was largely attributable to a decrease in expenses associated with the holding company formation in 2007 and the discontinuation of the consulting agreement previously mentioned.

The increase in advertising expenses from 2008 is primarily due to fees associated with a new public relations firm. The increase in 2008 over 2007 is mainly attributable to several new advertising campaigns and marketing research projects. The decrease in director expense in 2009 is primarily due to the departure of two directors who retired in May 2009.

The increase in other expense in 2009 over 2008 reflected operational losses in the second quarter of 2009 as well as the absence of a $242 thousand litigation liability cost reversed in 2008. In 2007, other expense included a pre-tax non-recurring charge of $242 thousand recorded in the fourth quarter for the potential obligation to Visa U.S.A. in connection with certain litigation indemnifications provided to Visa U.S.A. by Visa member banks. Such amount was reversed in 2008 against other expense upon Visa Inc.'s Initial Public Offering in 2008 as discussed in Note 13 to Consolidated Financial Statements.

Provision for Income Taxes

We reported a provision for income taxes of $7.8 million, $7.9 million, and $7.8 million for the years 2009, 2008, and 2007 respectively. The effective tax rates were 37.9%, 39.3%, and 38.7% for those same periods. These provisions reflect accruals for taxes at the applicable rates for federal income tax and California franchise tax based upon reported pre-tax income, and adjusted for the effects of all permanent differences between income for tax and financial reporting purposes (such as earnings on qualified municipal securities, BOLI and certain tax-exempt loans). Therefore, there are normal fluctuations in the effective rate from period to period based on the relationship of net permanent differences to income before tax. We have not been subject to an alternative minimum tax ("AMT") during these periods.

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Bancorp and the Bank have entered into a tax allocation agreement which provides that income taxes shall be allocated between the parties on a separate entity basis. The intent of this agreement is that each member of the consolidated group will incur no greater tax liability than it would have incurred on a stand-alone basis.

FINANCIAL CONDITION

Short-term Investment

At December 31, 2009, we had $15 million in a money market account that earned interest at a rate of 0.60% with a correspondent bank.

Investment Securities

We maintain an investment securities portfolio to provide liquidity and to generate earnings on funds that have not been loaned. Management determines the maturities and the types of securities to be purchased based on the need for liquidity to fund loans and the desire to attain a reasonable investment yield balanced with risk exposure. Table 6 shows the makeup of the securities portfolio by expected maturity at December 31, 2009 and 2008. Expected maturities differ from contractual maturities because the issuers of the securities may have the right to call or prepay obligations with or without call or prepayment penalties.

Table 6 Investment Securities

Type and Maturity Grouping	December 31, 2009				December 31, 2008			
(Dollars in thousands)	Principal Amount	Amortized Cost (2)	Market Value	Weighted Average Yield (1)	Principal Amount	Amortized Cost (2)	Market Value	Weighted Average Yield (1)
Held to maturity								
State and municipal								
Due within 1 year	$ 665	$ 671	$ 682	4.76 %	$ 200	$ 200	$ 200	4.92 %
Due after 1 but within 5 years	3,770	3,863	4,017	5.41	5,070	5,203	5,370	5.46
Due after 5 but within 10 years	11,840	12,403	12,831	5.72	5,140	5,312	5,488	6.39
Due after 10 years	13,335	13,459	13,256	5.78	12,635	12,843	12,077	5.71
Total held to maturity	29,610	30,396	30,786	5.69	23,045	23,558	23,135	5.80
Available for sale								
U. S. government agencies								

Due within 1 year	3,264	3,270	3,289	4.62	6	6	6	2.40
Due after 1 but within 5 years	36,986	37,339	38,672	4.99	46,383	46,627	47,269	5.11
Due after 5 but within 10 years	29,563	30,674	30,373	3.84	25,947	26,162	26,235	4.89
Due after 10 years	10,525	10,650	10,888	5.06	5,000	5,097	5,072	4.86
Total	80,338	81,933	83,222	4.56	77,336	77,892	78,582	5.02
Corporate CMOs								
Due within 1 year	2,088	2,103	2,075	3.91	734	734	727	5.25
Due after 1 but within 5 years	4,637	4,646	4,628	4.89	657	658	643	5.54
Due after 5 but within 10 years	8,068	8,070	7,893	4.62	---	---	---	---
Total	14,793	14,819	14,596	4.60	1,391	1,392	1,370	5.39
Total available for sale	95,131	96,752	97,818	4.57	78,727	79,284	79,952	5.03
Total	$ 124,741	$ 127,148	$ 128,604	4.83 %	$ 101,772	$ 102,842	$ 103,087	5.17 %

(1) Yields on tax-exempt securities are presented on a tax-equivalent basis.

(2) Book value reflects cost, adjusted for accumulated amortization and accretion.

Our investment securities portfolio, consisting primarily of obligations of U.S. government agencies, state and municipal securities and corporate collateralized mortgage obligations ("CMOs"), increased $24.7 million or 23.9% in 2009 to absorb some of our excess liquidity. U.S. government agency securities, which make up 64.9% and 75.9% of the portfolio at December 31, 2009 and 2008 respectively, increased $4.6 million in 2009. State and municipal securities, which represented 23.7% and 22.8% of the portfolio at December 31, 2009 and 2008 respectively, increased $6.8 million. Corporate collateralized mortgage obligation securities increased $13.2 million in 2009. The weighted average maturity of the portfolio at December 31, 2009 was approximately eighty months.

Mortgage-backed securities in the portfolio at December 31, 2009 totaled $92.8 million, which consisted of $13.1 million pass-through securities issued by FNMA and FHLMC, $65.1 million other mortgage backed securities issued or guaranteed by FNMA, FHLMC, or Government National Mortgage Association ("GNMA"), and $14.6 million of corporate CMOs. We generally invest in mortgage-backed securities with borrowers having strong credit scores and/or collateral compositions reflecting low loan-to-value ratios. Any investment securities in our portfolio that may be backed by sub-prime or Alt-A mortgages relate primarily to corporate CMOs. See Note 2 to Consolidated Financial Statements and Item 1A, Risk Factors, for more information on investment securities.

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Loans

Table 7 Loans Outstanding by Type at December 31

(Dollars in thousands)	2009	2008	2007	2006	2005
Commercial loans	$164,643	$146,483	$124,336	$117,391	$144,510
Real estate					
Commercial	478,885	467,170	389,741	311,692	282,564
Construction	91,289	121,981	97,153	116,790	112,116
Home equity	83,977	65,076	34,295	30,558	28,059
Other residential (a)	69,369	55,600	44,565	28,354	8,245
Indirect auto loans	---	---	---	84,141	77,612
Installment and other consumer loans	29,585	34,234	34,788	30,852	33,555
Total loans	917,748	890,544	724,878	719,778	686,661
Allowance for loan losses	(10,618)	(9,950)	(7,575)	(8,023)	(7,115)
Total net loans	$907,130	$880,594	$717,303	$711,755	$679,546

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

Commercial loan growth of $18.2 million in 2009 and $22.1 million in 2008 was the result of our continued emphasis on commercial and industrial lending, specifically asset-based lines of credit. We have historically targeted well-established local businesses with strong guarantors that have proven to be resilient in periods of economic stress.

Commercial real estate loans increased $11.7 million in 2009 and $77.4 million in 2008. The reduced volume of growth in 2009 largely reflected a decline in demand by qualified borrowers in our serving area. Of the commercial real estate loans at December 31, 2009, 69% are non-owner occupied and 31% are owner occupied. Our commercial real estate loan portfolio is weighted towards term loans for which the primary source of repayment is cash flow from net operating income of the real estate property. The increase in commercial real estate loans in 2008 was mainly driven by increased demand from existing customers. The following table summarizes our commercial real estate loan portfolio by the geographic location in which the property is located as of December 31, 2009 and 2008:

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Table 8 Commercial Real Estate Loans Outstanding by Geographic Location

(Dollar in thousands)	December 31, 2009		December 31, 2008	
Commercial real estate loans by geographic location	Amount	% of Commercial real estate loans	Amount	% of Commercial real estate loans
Marin	$ 224,018	46.8 %	$ 211,966	45.4 %
Sonoma	66,329	13.8 %	71,612	15.3 %
San Francisco	58,219	12.2 %	44,832	9.6 %
Alameda	30,265	6.3 %	41,880	9.0 %
Contra Costa	7,909	1.6 %	7,933	1.7 %
Napa	12,282	2.6 %	12,826	2.7 %
Sacramento	12,760	2.7 %	14,250	3.1 %
Other	67,103	14.0 %	61,871	13.2 %
Total	$ 478,885	100.0 %	$ 467,170	100.0 %

Construction loans decreased $30.7 million in 2009, primarily due to the successful completion and sell-through of construction development projects booked in prior years, a slow down in construction activity (primarily residential development), as well as a conscious effort to reduce our concentration in construction loans. Construction loans increased $24.8 million in 2008 due to both the lending on new projects as well as the funding of commitments carried over from 2007. Table 9 below shows an analysis of construction loans by type and location. Non-owner-occupied land loans of $43.8 million at December 31, 2009 included loans for lands specified for commercial development of $26.9 million and for residential development of $16.9 million, the majority of which are located in San Francisco and Marin counties.

Table 9 Construction Loans Outstanding by Type and Geographic Location

(Dollar in thousands)	December 31, 2009		December 31, 2008	
Construction loans by type	Amount	% of Construction Loans	Amount	% of Construction Loans
Single family non-owner-occupied	$14,903	16.3 %	$31,550	25.9 %
Single family owner-occupied	6,404	7.0 %	5,087	4.2 %
Commercial non-owner-occupied	6,444	7.1 %	1,429	1.2 %
Commercial owner-ccupied	3,204	3.5 %	2,617	2.1 %
Land non-owner-occupied	43,750	47.9 %	44,201	36.2 %
Land owner-occupied	----	----	1,798	1.5 %
Tenants-in-common and other	16,584	18.2 %	35,299	28.9 %
Total	$91,289	100.0 %	$121,981	100.0 %

Construction loans by geographic location	Amount	% of Construction Loans	Amount	% of Construction Loans
Marin	$19,729	21.6 %	$21,181	17.4 %
Sonoma	8,302	9.1 %	22,698	18.6 %
San Francisco	52,641	57.7 %	64,713	53.1 %
Alameda	2,545	2.8 %	5,033	4.1 %

Contra Costa	320	0.3	%	----	----	
Napa	879	1.0	%	1,136	0.9	%
Riverside	4,418	4.8	%	4,928	4.0	%
Other	2,455	2.7	%	2,292	1.9	%
Total	$91,289	100.0	%	$121,981	100.0	%

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The growth of home equity lines of credit normalized to $18.9 million in 2009 from $30.8 million in 2008. The significant growth in revolving home equity loans within our primary market area in 2008 was a result of our consumer loan promotional programs and other marketing support. Other residential real estate loans increased $13.8 million in 2009 and $11.0 million in 2008. The majority of the residential real estate loan growth was the result of the conversion from acquisition and development loans in the construction portfolio to tenants-in-common units in San Francisco, a trend that is expected to continue through 2010.

Approximately 86% and 84% of our outstanding loans are secured by real estate at December 31, 2009 and 2008, respectively. At December 31, 2009, approximately 24% of our commercial real estate loans and half of our residential real estate loans contain an interest-only feature as part of the loan terms. Approximately 93% of the interest-only commercial real estate loans and 92% of the residential real estate loans are considered to have low credit risk and are current with their payments. See also Item 1A, Risk Factors, regarding our loan concentration risk. As of December 31, 2009, approximately $72.3 million of our loans have interest reserves, the majority of which are construction loans. When we determine a loan is impaired before the interest reserve has been depleted, the interest funded by the interest reserve is applied against loan principal. As of December 31, 2009, $2.6 million of construction loans were on non-accrual status where the related interest reserves have not been depleted.

Variable rate loans at their established interest rate floors or ceilings are included as fixed rate loans in the following table. Table 10 shows a shift towards fixed rate loans within the portfolio in 2009 when compared to 2008 as variable rate loans continued to reprice down to their floor rates in a low-interest rate environment. The large majority of the variable rate loans are tied to independent indices (such as the Wall Street Journal prime rate or a Treasury Constant Maturity Rate). Substantially all loans with an original term of more than five years have provisions for the fixed rates to reset, or convert to a variable rate, after one, three or five years.

Table 10 Loan Portfolio Maturity Distribution and Interest Rate Sensitivity

	December 31, 2009				December 31, 2008			
(Dollars in thousands)	Fixed Rate	Variable Rate	Total	Percent	Fixed Rate	Variable Rate	Total	Percent
Due within 1 year	$114,727	$94,534	$209,261	22.8 %	$52,266	$153,504	$205,770	23.1 %
Due after 1 but within 5 years	198,635	76,501	275,136	30.0 %	162,527	105,427	267,954	30.1 %
Due after 5 years	336,616	96,735	433,351	47.2 %	275,101	141,719	416,820	46.8 %
Total	$649,978	$267,770	$917,748	100.0 %	$489,894	$400,650	$890,544	100.0 %
Percentage	70.82 %	29.18 %	100.00 %		55.01 %	44.99 %	100.00 %	

Allowance for Loan Losses

Credit risk is inherent in the business of lending. As a result, we maintain an allowance for loan losses to absorb losses inherent in our loan portfolio through a provision for loan losses charged against earnings. All specifically identifiable and quantifiable losses are charged off against the allowance. The balance of our allowance for loan losses is Management's best estimate of the remaining losses inherent in the portfolio. The ultimate adequacy of the allowance is dependent upon a variety of factors beyond our control, including the real estate market, changes in interest rate and economic and political environments. Based on the current conditions of the loan portfolio, Management believes that the $10.6 million allowance for loan losses at December 31, 2009 is adequate to absorb losses inherent in our loan portfolio. No assurance can be given, however, that adverse economic conditions or other circumstances will not result in increased losses in the portfolio.

The Components of the Allowance for Loan Losses

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

The first component, the specific allowance, results from the analysis of identified problem credits and the evaluation of sources of repayment including collateral, as applicable. Through Management's ongoing loan grading process, individual loans are identified that have conditions that indicate the borrower may be unable to pay all amounts due under the contractual terms. These loans are evaluated individually by Management and specified allowances for loan losses are established when the discounted cash flows of future payments or collateral value of collateral-dependent loans are lower than the recorded investment in the loan. Generally with problem credits that are collateral-dependent, we obtain appraisals of the collateral at least annually. We may obtain appraisals more frequently if we believe the collateral value is subject to market volatility, if a specific event has occurred to the collateral (e.g. tentative map has been filed), or if we believe foreclosure is imminent. Impaired loan balances increased from $6.8 million at December 31, 2008 to $12.2 million at December 31, 2009. The specific allowance totaled $45 thousand and $44 thousand at December 31, 2009 and 2008, respectively, as we charged off substantially all of our estimated losses related to specifically identified impaired loans as the losses are identified.

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

The total amount allocated for the second component is determined by applying loss estimation factors to outstanding loans. At December 31, 2009 and 2008, the allowance allocated by categories of credits totaled $7.6 million and $7.3 million, respectively. The increase mainly related to increased allowance factors for land loans related to the construction of residential subdivisions, commercial quick-qualifier loans and manufactured home loans, recognizing increased risk for these types of loans, as well as loan growth.

The third component of the allowance for loan losses is an economic component that is not allocated to specific loans or groups of loans, but rather is intended to absorb losses caused by portfolio trends, concentration of credit, growth, and economic trends. At December 31, 2009 and 2008, the general valuation allowance, including the economic component, totaled $3.0 million and $2.7 million, respectively. Starting in late 2008, we witnessed financial difficulties experienced by borrowers in our market, where real estate sale prices have declined and holding periods have increased. The U.S. economy is still experiencing significantly reduced business activity as a result of, among other factors, disruptions in the financial system, dramatic declines in the housing prices, and an increasing unemployment rate. There have been significant reductions in spending by consumers and businesses. In response to this, we have been proactive in evaluating reserve percentages for economic and other qualitative loss factors used to determine the adequacy of the allowance for loan losses. The increase to the third component of the allowance for loan losses reflected such evaluation.

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Table 11 shows the allocation of the allowance by loan type as well as the percentage of total loans in each of the same loan types.

Table 11 Allocation of Allowance for Loan Losses

(Dollars in thousands)	December 31, 2009 Allowance balance allocation	December 31, 2009 Loans as percent of total loans	December 31, 2008 Allowance balance allocation	December 31, 2008 Loans as percent of total loans	December 31, 2007 Allowance balance allocation	December 31, 2007 Loans as percent of total loans	December 31, 2006 Allowance balance allocation	December 31, 2006 Loans as percent of total loans	December 31, 2005 Allowance balance allocation	December 31, 2005 Loans as percent of total loans
Commercial loans (a)	$2,544	17.9 %	$2,306	16.5 %	$1,811	17.2 %	$1,710	16.3 %	$1,641	21.1 %
Real Estate										
Commercial (a)	4,006	52.2	3,911	52.5	2,866	53.8	2,262	43.3	2,205	41.1
Construction	1,832	9.9	2,118	13.6	1,659	13.4	1,995	16.2	1,764	16.3
Home Equity	586	9.2	453	7.3	205	4.7	182	4.3	139	4.1
Other residential	734	7.6	588	6.2	426	6.1	271	3.9	17	1.2
Installment and other consumer	662	3.2	563	3.9	430	4.8	1,389	16.0	1,253	16.2
Unallocated allowance	254	N/A	11	N/A	178	N/A	214	N/A	96	N/A
Total allowance for loan losses	$10,618		$9,950		$7,575		$8,023		$7,115	
Total percent		100.00%		100.00%		100.00%		100.00%		100.00%

(a) Certain allowance for loan losses attributable to commercial real estate loans were classified as commercial loans in prior years as they overlap commercial and real estate groups. In 2009, they are reclassified as part of the commercial real estate category to be consistent with Table 7 grouping.

The allowance for loan losses as a percentage of loans totaled 1.16% at December 31, 2009, compared to 1.12% at December 31, 2008. The increase in the allowance for loan losses as a percentage of loans reflect increased allowance factors for land loans related to the construction of residential subdivisions, commercial quick-qualifier loans, and manufactured home loans, as well as a higher level of general valuation allowance mainly related to the prevailing weaker economic environment.

Table 12 shows the activity in the allowance for loan losses for each of the years in the five-year period ended December 31, 2009. Net charge-offs totaled $4.8 million in 2009, primarily related to commercial and construction loans secured by real property where the value of collateral has declined, and to a lesser extent, personal loans and home equity loans. Our recent losses, which resulted in higher charge-off ratio as seen in the following table, have stemmed primarily from the land development and single-family residential construction projects in Oregon and

Sonoma County in California, where property prices have been affected more significantly than our primary market of Marin County. Net charge-offs in 2008 totaling $2.6 million primarily relate to construction loans secured by real property where the value of collateral has declined. Net charge-offs in 2007 totaled $85 thousand. The percentage of net charge-offs to average loans was 0.53% in 2009, compared to 0.33% in 2008 reflecting the factors discussed above.

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Table 12 Allowance for Loan Losses at December 31

(Dollars in thousands)	2009	2008	2007	2006	2005
Beginning balance	$9,950	$7,575	$8,023	$7,115	$6,110
Cumulative-effect adjustment of election of fair value accounting on indirect auto portfolios1	---	---	(1,048)	---	---
Provision for loan losses	5,510	5,010	685		