BANK OF MARIN

2005 ANNUAL REPORT

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DIRECTORS AND EXECUTIVE OFFICERS

Judith O'Connell Allen, *Community volunteer, Chairman, Bank of Marin*
* Nancy R. Boatright, *Vice President & Corp. Sec., Bank of Marin*
* Russell A. Colombo, *Exec. Vice President & COO, Bank of Marin*
* Christina J. Cook, *Exec. Vice President & CFO, Bank of Marin*
James E. Deitz, *President, Marin Business Services*
W. Robert Griswold, Jr., *President and CEO, Bank of Marin*
Robert Heller, *Former Governer, Federal Reserve Board & former President and CEO, Visa U.S.A.*
Ray Hoffman, III, *Proprietor, Hoffman Development Co.*
Norma J. Howard, *Business consultant*
J. Patrick Hunt, *Partner, Hunt Investments*
H. C. Jackson, *Retired merchant*
James D. Kirsner, *Business consultant*
* Larry Klaustermeier, *Sr. Exec. Vice President & CCO, Bank of Marin*
* Patrick J. London, *Exec. Vice President & Director of Wealth Management Services, Bank of Marin*
Stuart D. Lum, *President, Pacific Mortgage Investors*
Joseph D. Martino, *Retired banker*
James L. Placak, *Employee Benefits Consultant*
Joel Sklar, MD, *Partner, Cardiology Assoc. of Marin & San Francisco*
Brian M. Sobel, *Partner, Sobel Communications*
J. Dietrich Stroeh, *Partner, CSW/Stuber-Stroeh Engineering Group*
Jan I. Yanehiro, *Owner, Media and Marketing Strategic Planning*

* These executive officers are not also directors.

This annual report serves as the annual disclosure statement for the purposes of part 350 of the Federal Deposit Insurance Corporation rules. It has not been reviewed or confirmed for accuracy or relevance by the FDIC.

BANK STAFF

Mary Adams
Diane Akers
Dino Alessio
Nova Alexander
Terry Aman
Joanne Amaral
Michele Anderson
Natalie Andryushina
Pamela Angliss
Tamara Austin
Boualay Bala
Ken Beagle
Susan Beaver
Melodie Behm
Robin Bentivegna
Joyce Bjerke
Boo Boero
Josiane Bougard
Arlene Brians
Celine Cabrera-Menique
Vanessa Camacho
Scott Canaan
Brian Carlson
Sunshine Castle
Nick Castro
Gaik Chan
Nancy Chapin
Angela Colglazier
Alana Comaduran
Kay Commins
Anooshik Cronin
Sarah Dempsey
Shelby DiGrazia
Amra Dizdarevic
Barbara Dougherty
Mary Jane Elmore
Florette Eugene
Lisa Evans-Colvin
Susan Farac
Coy Ferini
Giuliana Ferrer
Gary Ford
Vince Franceschi
Hung Fung
Karen Garbarino
Rebecca Gardner
Joyce Giannini
Jonathan Girard
David Gonzalez
Elizabeth Greene
Judy Grider
Julie Griffin
Vicki Gruber
Sarah Guenther
Suzanne Guenza
Sal Gutierrez
Jessica Ham
Genny Harris-Boyd
Debora Hartlieb
Viviana Henao
Kyle Hixon
James Hoffman
Helen Hoffmann
Josh Iversen
Lisa Jaffurs
Nawal Jarjoura
Tracy Jerves
Kevin Johnson
Veronika Johnson
Claudia Just Olsen
Merlee Katzman
Mindy King
Lisa Kleinecke
David Kough
Daniel MacDonneil
Nicolette MacDonneil
Katherine Madsen
Lisa Mallen
Connie Marelich
Joan Marino
Stephanie McCleod
Mary McDermott
Melina Mehiel
Mary Melville
Victor Mencarelli
Edgar Mendoza
Krissy Meyer
Judy Morey
Catherine Moriarty
Mohammed Nadeem
Marisol Negrete
Eric Nelson
Tim O'Connor
Jon O'Halloran
Anotinette Oroz
Jaime Ortiz
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John Pedone
Irene Pelmear
Shirley Pettit
Patricia Plytas
Diane Pollock
Benjamin Pulido
Nancy Reich
Linda Reid
Melanie Renn
Isaias Reyes
Penny Reynolds
Marie Rieck
Fabiola Rodriguez
Emilie Rogier
Mike Roney
Stephen Ross
Saroj Sachdev
Sean Scullion
Ellie Shattuck
Jaime Sheets
Nikki Singh
Mari Soria
Lloyd Stasiowski
David Strickland
Lee Tang-Chi
Melanie Taylor
Jamie Thigpen
David Thomas
Kim To
Cindy Toscanini
Silia Townsend
Ray Vallerga
Patty Varela
Nicole Wallace
Renee Weaver
Duncan Young

CORPORATE OFFICERS

Executive Vice President
Alexandra Souza

Senior Vice Presidents
Douglas Caulfield
Kevin Coonan
Holly Ford
Deborah Hoke Smith
Frank Murray
Elizabeth O'Farrell
Peter Pelham
Elizabeth Reizman
David Schmidt
Keith Zimmerman

Vice Presidents
Sue Anderson
Angela Bergamini
Michael Callan
Joan Capurro
Sal Catinella
Judi Cole
Phyllis Cope
Barbara Dalmau
Richard DeRamon
Pat Feingold
Sharon Fox
Bob Gotelli
Janet Hayward
Karen Hegarty
Sherri Hendrickson
Wayne Hoffer
Fran Hoke
Martha Hollenbeck
Joseph Iacocca
Donald Jarvis
Nancy Jones
Steve Kambur
Carol Kneis
Mae Lacourse
Thomas Leong
Bill Montgomery
Sandra Murray
Frank Perachiotti, Jr.
Carole Reif
Lucy Rezendes
Dan Rheiner
Richard Ronsheimer
Renee Rymer
Mary Ann Shoemaker
Liza Silva
Linda Steidle
William Sullivan
Rich Ugarte
Sherrie Wallace
Jackie Williams
Carol York

Assistant Vice Presidents
Marshall Appleton
Fabia Butler
Megan Carter
Jenny Church
Chris Colliver
Faith Giosso
Kevin Gish
April Gobershock
Jeff Graham
Eileen Katz
Carrie Lee
Lynn McHale
Bambi Riebesell
Suzanne Ross
Renee Story
Allison Thornton
Carol Trueblood
Bonnie Wilson
Nicole Young

MESSAGE TO OUR SHAREHOLDERS:

Bank of Marin grew in many ways last year, especially in the number of products we offer our existing and expanding list of customers. An even fuller array of products is on the horizon. We also grew in size, expanding further into Sonoma County with an August opening of a second Petaluma branch and a third in the first quarter of 2006. In the late summer all of our non-branch staff will be relocating to a single facility, Pell Plaza, in Novato. We expect to achieve significant efficiencies from having our lending, operations and administrative staffs working together under one roof.

We're also pleased to report continued growth in earnings, up 23% from last year to $11.7 million. Of course, central to our growth is our unwavering commitment to providing legendary service to our customers, creating a satisfying work environment for our employees and making a real difference in the communities we serve, all the while being mindful of our obligation to work in the best interest of our shareholders.

Some of the exciting new products and services we added in 2005 are as follows:

- **Reverse Mortgages** – A unique home loan based on the home's equity, working in reverse, so that payments are made directly to the homeowner (62 and older). The funds can be used for any purpose, and there's no change in ownership of the home.
- **Tenancy in Common Loans** – You may have read about this, because we received lots of positive press as the first bank to offer fractional interest TIC loans in a pilot program establishing an affordable housing ownership option in San Francisco.
- **Pentegra Retirement Services** – We've partnered with this nationally known retirement plan company to provide local businesses with affordable employee 401(k) plan services.
- **Rewards Credit Card** – By using our new Visa Points2U Rewards Card, customers earn points that can be redeemed for travel, gifts and gift cards.
- **Long Term Care Insurance** – We've partnered with a licensed insurance specialist to offer this combination of long term care and life insurance. To the extent it is not needed for long-term care coverage, the insurance provides an income tax-free death benefit to heirs.
- **Bank of Marin Foundation** – This non-profit charity, affiliated with the Marin Community Foundation and coordinated by the Bank's Wealth Management Services professionals, enables clients to organize and simplify their charitable giving.

We also have plans to broaden our array of products in 2006 by adding Residential Mortgages, Equipment Lease Financing and Asset-based Lending.

We are especially proud that in 2005 we were named "One of the Top 100 Best Places to Work in the Bay Area" by *San Francisco Business Times*. This is a direct tribute to our wonderful, dedicated staff, who feel a sense of ownership in Bank of Marin and whose primary focus is serving the individual needs of each of our customers. Through the Bank of Marin Employee Stock Ownership Plan (ESOP), our employees, as a group, are the largest single shareholder and own almost 6% of the Bank's stock.

We deeply appreciate your ongoing support. We want you to know that measured, strategic growth is all a part of our total commitment to improving the lives of the people, businesses, and communities of Marin and southern Sonoma counties, and to growing shareholder value.

/s/ Judith O'Connell Allen	*/s/ W. Robert Griswold, Jr.*
Judith O'Connell Allen Chairman of the Board	W. Robert Griswold, Jr. President & Chief Executive Officer

BUSINESS OF THE BANK

General

Bank of Marin (the 'Bank') was incorporated in August 1989, received its charter from the California Superintendent of Banks (now the California Department of Financial Institutions) and commenced operations in January 1990. The Bank is an insured bank under the Federal Deposit Insurance Act and, like most state chartered banks of its size in California, is not a member of the Federal Reserve System.

Market Area and Customer Base

The Bank's market area stretches from southern Sonoma County south to the Golden Gate Bridge and lies between the Pacific Ocean on the west and San Pablo Bay to the east. Of this larger market area the Bank has designated the communities of San Rafael, Corte Madera, Greenbrae, Larkspur, Kentfield, Ross, San Anselmo, Tiburon, Belvedere, Mill Valley, Sausalito, Terra Linda, Bel Marin Keys, Novato and Petaluma as its primary market areas. The Bank's customer base is made up of business and personal banking relationships from the communities near the branch office locations.

Loans

The Bank offers a broad range of commercial and retail lending programs including commercial loans, construction financing, consumer loans including auto loans (direct and indirect) and home equity loans and lines of credit. The Bank also offers a proprietary Visa credit card combined with a rewards program to its customers, including a Business Visa program for business and professional customers. For reporting purposes these programs are consolidated into the general categories of commercial loans, real estate loans and installment loans. At December 31, 2005, these broad categories totaled $686.7 million, and accounted for approximately 21%, 63% and 16%, respectively, of the loan portfolio. The interest rates on most commercial loans are tied to the Wall Street Journal prevailing prime rate and change as rate changes are reported. A majority of these loans have a term of one year or less.

Real estate loans include commercial real estate loans, consumer loans and lines of credit secured by real property, and construction financing. Commercial real estate loans are generally written for ten years with fixed rates for the first 5 years and then adjusting to an indexed spread for the remaining 5 years. Consumer real estate secured loans include equity lines of credit and installment loans for various consumer purposes. Generally, equity lines are for a term of ten years or less and are secured by first or second deeds of trust on residential properties and bear interest at a floating rate tied to the Wall Street Journal prevailing prime rate. Usually, home equity installment loans are for a term of 15 years or less and have a fixed rate of interest.

The Bank offers construction financing to developers of single-family and multi-family residences and commercial real estate properties. Construction loans are typically repaid through permanent financing by the Bank or from other financial institutions. Usually these loans have terms of twelve to eighteen months, have fixed rates of interest or floating rates tied to the Wall Street Journal prevailing prime rate, and are secured by first deeds of trust.

Deposits

The Bank offers a variety of checking and savings accounts, and a number of time deposit alternatives, including interest bearing and non-interest bearing personal and business checking accounts and time certificates of deposit. The Bank also offers direct deposit of payroll, social security and pension checks. Bank of Marin's ATM system is tied into both the STAR and PLUS networks, and the Bank offers a proprietary Visa check card.

Bank of Marin attracts deposits from individuals, merchants, small to medium sized businesses and professionals who live and/or work in our market areas. More than 90% of our deposits come from Marin and southern Sonoma counties. Approximately 57% of the Bank's deposits are from businesses and 43% are from individuals. The Bank as a matter of policy does not accept brokered deposits.

Wealth Management Services

In 1998, the Bank began to offer investment advisory and personal trust services. The services include customized portfolio management in partnership with subadvisors, using individual stocks, bonds, exchange-traded funds and cash; professional management of all trust assets including real estate and other specialty assets; tax reporting, safekeeping and accounting of assets; and estate settlement and administration of all areas of living, testamentary and charitable trusts. The Bank also offers 401K plan management through a third party and partners with a licensed insurance specialist to provide asset-based long-term care insurance.

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following discussion of the Bank's financial condition and results of operations for each of the years in the three-year period ended December 31, 2005 should be read in conjunction with the Bank's financial statements and related notes thereto, located on pages 22 to 39 of this Annual Report. Average balances, including balances used in calculating certain financial ratios, are generally comprised of average daily balances.

On April 15, 2004 the Board of Directors declared a 3-for-2 stock split payable May 24, 2004. In April 2005 and April 2003 the Board of Directors declared 5% stock dividends. Earnings per share and book value per share amounts have been restated for prior periods to reflect the stock split and stock dividends. Additionally, the Board of Directors declared quarterly cash dividends of ten cents per common share totaling $495 thousand in August 2005 and $495 thousand in November 2005. In June of 2004 the Bank declared a cash dividend of forty cents per share totaling $1.8 million.

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.

The Bank's forward-looking statements include descriptions of plans or objectives of management for future operations, products or services, and forecasts of its 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 the Bank's earnings in future periods. A number of factors - many of which are beyond the Bank's control - could cause future results to vary materially from current management expectations. Such factors include, but are not limited to, general economic conditions, 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 the Bank's operations, pricing, products and services. These and other important factors are detailed in various Federal Deposit Insurance Corporation filings made periodically by the Bank, copies of which are available from the Bank at no charge. Forward-looking statements speak only as of the date they are made. The Bank does 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.

Critical Accounting Policy

Allowance for Loan Losses
Management has considered the accounting principles upon which the Bank's financial reporting depends and has determined the allowance for loan losses to be the Bank's most critical accounting policy. The allowance for loan losses is discussed in further detail beginning on page 14 of this Annual Report. The Bank formally assesses the adequacy of the allowance for loan losses on a quarterly basis. Determination of the adequacy is based on ongoing assessments of the probable risk in the outstanding loan portfolio. 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 re-graded as they are renewed, when there is a new loan to the same borrower and/or when identified facts demonstrate heightened risk of nonpayment. Re-grading of larger problem loans occurs at least quarterly. Confirmation of the quality of the grading process is obtained by independent credit reviews conducted by consultants specifically hired for this purpose and by various bank regulatory agencies.

The Bank's method for assessing the appropriateness of the allowance includes specific allowances for identified problem loans, an allowance factor for pools of credits, and allowances for changing environmental factors (e.g., portfolio trends, concentration of credit, growth, economic factors, etc.). Allowances for identified problem loans are based on specific analysis of individual credits. Loss estimation factors for loan pools are based on analysis of local economic factors applicable to each loan pool. Due to our minimal historic losses, loss estimation factors are based only in part on the previous historical loss experience for each pool. 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.

Future Adoption of Accounting Standard

In December 2004, the Financial Accounting Standards Board ("FASB") adopted Statement of Financial Accounting Standards ("SFAS") No.123-R, Share-Based Payment, which addresses the accounting for share-based payment transactions in which the Bank receives services in exchange for stock options of the Bank. SFAS No.123-R requires the Bank to recognize the grant-date fair value of stock options issued to employees and directors in the income statement.

The Bank expects to adopt the requirements of SFAS No.123-R prospectively in January 2006 and estimates the impact to be an increase to non-interest expense and reduction to net income of approximately $150 thousand to $200 thousand per quarter.

For additional discussion of the impact of the adoption of SFAS No.123-R, see Note 1 of the Notes to Financial Statements under the sub heading "*Stock Based Compensation*."

RESULTS OF OPERATIONS

Overview

Highlights of the Bank's results are presented in the following table.

	As of and for the 12 months ended December 31,		
(Dollars in thousands, except per share data)	**2005**	**2004**	**2003**
For the period:			
Net income	$11,737	$9,518	$7,473
Net income per share*			
Basic	2.39	1.99	1.62
Diluted	2.23	1.85	1.51
Return on average equity	16.15%	15.64%	14.46%
Return on average assets	1.46%	1.38%	1.28%
Cash dividend payout ratio	8.37%	20.10%	---
Efficiency ratio	52.14%	54.68%	58.20%
At period end:			
Book value per share*	$15.77	$13.55	$11.94
Total assets	840,449	737,094	642,607
Total loans	686,661	576,957	450,881
Total deposits	721,172	645,079	584,116
Loan-to-deposit ratio	95.21%	89.44%	77.19%

*These per-share amounts have been adjusted for all stock splits and dividends.

The 2005 financial performance for the Bank produced growth in loans, deposits and net income. Total deposits reached $721.2 million at December 31, 2005, an increase of $76.1 million or 11.8% from the prior year. Total gross loans finished the year at $686.7 million compared to $577.0 million in 2004, representing an increase of $109.7 million or 19.0%. Net income for 2005 was $11.7 million or $2.23 per share (diluted) compared with $9.5 million or $1.85 per share (diluted) in 2004. The year over year change in net income represents an improvement of 23.3%.

The Bank's return on average assets (ROA) and return on average equity (ROE) improved over the prior year. In 2005 the Bank's ROA and ROE were, respectively, 1.46% and 16.15% compared to 1.38% and 15.64% in 2004. Management continues to balance the desire to increase the return ratios to those of its peers with the desire to increase the Bank's deposit penetration in Marin and Sonoma Counties. For the twelve-month period from June 2004 to June 2005 (the latest date for which the information is available), the Bank's market share of total Marin County deposits increased from 8.47% to 8.82%.

Net interest income was a principal source of the earnings improvement for the year, as it reached $39.4 million, an increase of $7.2 million or 22.4% over 2004. The interest income component of net interest income was up 31.6% to $49.5 million, and is primarily the result of the increase in the size of the Bank's loan portfolio. Total interest expense of $10.0 million in 2005 was up from 2004 by $4.7 million, or 87.6%, primarily attributable to an increasing interest rate environment as well as growth in the Bank's deposit portfolio.

The Bank provided $1.5 million to the allowance for loan losses in 2005, and net charge-offs were $536 thousand. This compares to a provision of $934 thousand and net charge-offs of $282 thousand in 2004. At year-end 2005 and 2004, the allowance for loan losses as a percentage of total loans was 1.04% and 1.06%, respectively.

Non-interest income is comprised of service charges on deposit accounts, Wealth Management Services (WMS) revenue, and other income. In 2005, total non-interest income was $3.7 million, which is an improvement of $65 thousand or 1.78% over 2004. Service charges on deposit accounts decreased to $1.0 million versus $1.1 million one year ago. WMS revenue grew to $958 thousand, an increase of $36 thousand, and other income finished the year at $1.7 million compared to $1.6 million in the prior year.

Non-interest expenses increased from $19.6 million in 2004 to $22.5 million in 2005, an increase of $2.9 million or 14.7% increase and was largely due to the growth in the operations of the Bank. The overall efficiency of the Bank improved from 54.68% in 2004 to 52.14% in 2005.

Assets of the Bank totaled $840.4 million at December 31, 2005, an increase of $103.4 million or 14.0% from December 31, 2004.

Summary of Quarterly Results of Operations

Table 1 sets forth the quarterly results of operations for 2005 and 2004.

Table 1 Summarized Statement of Operations

	2005 Quarters Ended				2004 Quarters Ended			
(Dollars in thousands)	**Dec. 31**	**Sept. 30**	**June 30**	**Mar. 31**	**Dec. 31**	**Sept. 30**	**June 30**	**Mar. 31**
Interest income	$13,754	$13,097	$11,745	$10,889	$10,488	$9,821	$8,855	$8,425
Interest expense	3,041	2,853	2,340	1,809	1,535	1,374	1,200	1,243
Net interest income	10,713	10,244	9,405	9,080	8,953	8,447	7,655	7,182
Provision for loan losses	334	491	390	326	425	304	105	100
Net interest income after provision for loan losses	10,379	9,753	9,015	8,754	8,528	8,143	7,550	7,082
Non-interest income	954	963	921	870	951	906	916	870
Non-interest expense	5,866	5,679	5,403	5,550	5,152	4,991	4,745	4,732
Income before provision for income taxes	5,467	5,037	4,533	4,074	4,327	4,058	3,721	3,220
Provision for income taxes	2,135	1,951	1,737	1,551	1,662	1,551	1,404	1,191
Net income	$3,332	$3,086	$2,796	$2,523	$2,665	$2,507	$2,317	$2,029
Net income per common share*								
Basic	$0.67	$0.63	$0.57	$0.52	$0.55	$0.52	$0.49	$0.43
Diluted	$0.63	$0.59	$0.53	$0.48	$0.50	$0.49	$0.45	$0.40

*These per-share amounts have been adjusted for all stock splits and dividends.

Net Interest Income

Net interest income is the Bank's largest source of income (91.4%). Net interest income is the difference between the interest earned on loans, investments and other interest earning assets, and the interest expense 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. Comparisons of net interest income are frequently made using net interest margin and net interest rate spread. Net interest margin is expressed as net interest income divided by average 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 interest earning assets with interest expense and interest bearing liabilities for the three years 2005, 2004 and 2003. The table also indicates net interest income, net interest margin and net interest rate spread for each year.

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

	2005			2004			2003		
(Dollars in thousands)	Average Balance	Interest Income/ Expense(1)	Yield/ Rate(1)	Average Balance	Interest Income/ Expense(1)	Yield/ Rate(1)	Average Balance	Interest Income/ Expense(1)	Yield/ Rate(1)
Assets									
Federal funds sold	$ 4,343	$156	3.58%	$ 5,410	$ 61	1.13%	$ 23,312	$ 243	1.04%
Investment securities									
U. S. Treasury securities	7,082	155	2.19	12,265	324	2.64	11,459	518	4.52
U. S. government agencies	73,212	2,930	4.00	67,888	2,257	3.32	32,672	1,018	3.11
Other	8,701	448	5.14	13,725	795	5.79	12,303	791	6.43
Municipal bonds	21,838	1,141	5.23	27,843	1,468	5.27	23,991	1,381	5.72
Loans and bankers' acceptances.(2)	640,694	44,988	7.02	514,299	33,140	6.44	434,908	29,301	6.74
Total interest-earning assets	755,870	49,818	6.60	641,430	38,045	5.93	538,645	33,252	6.17
Cash and due from banks	32,407			35,009			33,056		
Bank premises and equipment, net	4,229			4,198			4,361		
Interest receivable and other assets, net	10,989			10,621			5,513		
Total Assets	$803,495			$691,258			$581,575		
Liabilities and Stockholders' Equity									
Interest-bearing transaction accounts	70,710	276	0.39	66,084	257	0.39	$ 51,664	207	0.40
Savings and money market accounts	333,165	5,530	1.66	298,091	2,961	0.99	226,288	2,426	1.07
Time accounts	116,302	3,396	2.92	93,189	1,968	2.11	110,740	2,534	2.29
Purchased funds	16,074	543	3.38	2,805	49	1.74	91	2	1.71
Borrowed funds	5,000	298	5.97	2,705	117	4.32	--	--	--
Total interest-bearing liabilities	541,251	10,043	1.86	462,874	5,352	1.16	388,783	5,169	1.33
Demand accounts	185,873			164,881			138,214		
Interest payable and other liabilities	3,676			2,639			2,890		
Stockholders' equity	72,695			60,864			51,688		
Total Liabilities and Stockholders' Equity	$803,495			$691,258			$581,575		
Net Interest Income		$39,775			$32,693			$28,083	
Net Interest Margin			5.26%			5.10%			5.21%
Net Interest Spread			4.74%			4.78%			4.84%

(1) Yields and interest income are presented on a taxable equivalent basis using the Federal statutory rate of 34 percent.
(2) Average balances on loans outstanding include non-performing loans, if any. The amortized portion of net loan origination fees (costs) is included in interest income on loans, representing an adjustment to the yield.

In 2005, the Bank's net interest income increased by $7.2 million, or 22.4% over 2004 and by $4.6 million, or 16.6% in 2004 over 2003. The Bank's net interest margin improved to 5.26% in 2005 compared to 5.10% in 2004, and declined in 2004 from 5.21% in 2003. The increases in net interest income are attributable primarily to growth in interest earning assets, mainly loans which comprise the largest and highest yielding component of earning assets, as well as higher yields due to the increasing rate environment. Net interest income was positively affected by a shift in the mix of asset balances to higher yielding loans from lower yielding securities in 2005 and from lower yielding Federal funds sold to securities and loans in 2004. Partially offsetting these increases were higher costs of interest bearing funding sources, primarily money market and CD accounts, as well as growth in the balances of interest-bearing liabilities in 2005 and 2004. The Bank’s 2005 average loan-to-deposit ratio was 90.7%, up from 82.7% in 2004 and 82.5% in 2003.

Earning assets consist of loans, investment securities and Federal funds sold. Average earning assets of $755.9 million in 2005 represented an increase of 17.8% from 2004. The growth in earning assets from 2003 to 2004 was 19.1%. The Bank’s yield on interest earning assets improved from 5.93% in 2004 to 6.60% in 2005 due to increasing yields on the largest components of earning assets which are loans and agency securities. The yield on earning assets declined from 6.17% in 2003 to 5.93% in 2004 due to a decline in average market interest rates.

The yield on the loan portfolio, which comprised 84.8% and 80.2% of average earning assets in 2005, and 2004, respectively, increased from 6.44% in 2004 to 7.02% in 2005 . New loans in 2005 were added to the portfolio at higher market rates due to a generally rising interest rate environment. The yield on loans declined from 6.74% in 2003 to 6.44% in 2004 due to a decline in market rates.

The yield on agency securities which comprised 9.7% of average earning assets in 2005, increased from 3.32% in 2004 to 4.00% in 2005 and from 3.11% in 2003 to 3.32% in 2004. The Bank’s agency securities generally have an average life of approximately three years and will mature or be called more quickly than other securities in the Bank’s portfolio. The increase in the volume and changes in yield on agency securities primarily relates to purchases of securities at then-current market rates in a rising rate environment.

Market rates are in part based on the Federal Reserve Open Market Committee target Federal funds interest rate (the interest rate banks charge each other for short-term borrowings). The increase in the Federal funds sold and purchased rates is the result of rate increases implemented by the Federal Reserve Board. In 2004 there was a 125 basis point increase in the Federal funds interest rate and in 2005, a 200 basis point increase.

The declines in yields on the Bank’s U.S. Treasury securities, other securities (largely comprised of corporate notes) and municipal bonds from 2004 to 2005 and from 2003 to 2004 primarily relate to maturities of older higher-yielding instruments.

The Bank’s average balance of interest-bearing liabilities was $541.3 million in 2005, an increase of 16.9% from $462.9 million in 2004. The growth in interest bearing liabilities from 2003 to 2004 was 19.1%. The rate paid on interest bearing liabilities increased to 1.86% in 2005 from 1.16% in 2004. This is primarily the result of the rising market interest rates and adjustments due to competitive market conditions. The rate paid on interest bearing liabilities declined from 1.33% in 2003 to 1.16% in 2004. This is primarily the result of a lagged effect of changes in market interest rates originating from actions taken by the Federal Reserve Open Market Committee in 2003 and 2004.

The mix of customer deposit types remained fairly constant from 2004 to 2005 with savings and money market accounts the largest component. All categories of deposits showed increases over 2004. Interest transaction accounts grew 7.0% to $70.7 million. Savings and money market accounts grew 11.8% to $333.2 million. Time deposits grew 24.8% to $116.3 million. Purchased funds increased from $2.8 million to $16.1 million from 2004 to 2005 to support the growth in earning assets and include a $10 million fixed-rate FHLB advance issued in July 2005 at 4.23%. Interest on purchased funds increased from 1.74% in 2004 to 3.38% in 2005. Interest on other borrowed funds increased from 4.32% in 2004 to 5.97% in 2005 due to higher LIBOR market rates.

Interest rate changes can create fluctuations in the Bank’s net interest margin due to an imbalance in the repricing or maturity of assets or liabilities. Interest rate risk exposure is managed with the goal of minimizing the impact of interest rate volatility on the Bank’s net interest margin. The Bank’s balance sheet is fairly evenly matched, which tends to minimize changes to the Bank’s net interest margin;

however, it is slightly asset sensitive. In 2005, the Bank achieved a net interest margin (NIM) of 5.26%, up from the NIM of 5.10% experienced in 2004 and 5.21% in 2003.

Table 3, Analysis of Changes in Net Interest Income, separates the change in the Bank's 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 shows the impact on income of balance sheet changes and the changes in market interest rate levels which occurred during 2005 and 2004.

Table 3 Analysis of Changes in Net Interest Income

	Year ended December 31, 2005 compared to 2004			Year ended December 31, 2004 compared to 2003		
(Dollars in thousands)	Volume	Yield/ Rate*	Total	Volume	Yield/ Rate*	Total
Assets						
Federal funds sold	$ (14)	$ 109	$ 95	$ (187)	$ 5	$ (182)
Investment securities						
U. S. Treasury securities	(121)	(48)	(169)	36	(230)	(194)
U. S. government agencies	186	487	673	1,096	143	1,239
Other	(266)	(81)	(347)	(42)	46	4
Municipal bonds	(316)	(11)	(327)	186	(99)	87
Loans and bankers' acceptances	8,670	3,178	11,848	5,348	(1,509)	3,839
Total interest-earning assets	8,139	3,634	11,773	6,437	(1,644)	4,793
Liabilities						
Interest-bearing transaction accounts	19	--	19	58	(8)	50
Savings and money market accounts	380	2,189	2,569	770	(235)	535
Time accounts	561	867	1,428	(402)	(164)	(566)
Purchased funds	412	82	494	46	1	47
Borrowed funds	124	57	181	117	--	117
Total interest-bearing liabilities	1,496	3,195	4,691	589	(406)	183
Net Interest Income	$6,643	$439	$7,082	$5,848	$(1,238)	$4,610

* Variances due to changes in both yield/rate and volume (mix) are allocated to yield/rate.

Provision for Loan Losses

The Bank formally assesses the adequacy of the allowance on a quarterly basis. The Bank provides as an expense an amount to bring the allowance for loan losses to a level to provide adequate coverage for probable loan losses. The adequacy of the allowance for loan losses is evaluated based on several factors, including growth of the loan portfolio, analysis of probable losses in the portfolio and recent loss experience. Actual losses on loans are charged against the allowance and the allowance is increased through the provision charged to expense. The Bank's provision for loan losses in 2005 was $1.5 million versus $934 thousand for 2004 and $686 thousand in 2003. Net charge-offs for 2005 totaled $536 thousand compared with $282 thousand in 2004 and $262 thousand in 2003. Table 4, Non-performing Loans at December 31, shows that there were no non-performing assets at December 31 for the last five years.

Table 4 Non-performing Loans at December 31

	2005	2004	2003	2002	2001
Non accrual loans	$ --	$ --	$ --	$ --	$ --
Accruing loans past due 90 days or more	--	--	--	--	--
Other real estate owned	--	--	--	--	--
Total non-performing assets	$ 0	$ 0	$ 0	$ 0	$ 0

The Bank's policy is to place loans on non-accrual status when management believes that there is serious doubt as to the collection of principal or interest, or when they become contractually past due by 90 days or more with respect to principal or interest, except for loans that are both well secured and in the process of collection. When loans are placed on non-accrual status, any accrued but uncollected interest is reversed from current income, and additional income is recorded only as payments are received.

Non-interest Income

Non-interest income includes service charges on deposit accounts, WMS income and other income. Non-interest income grew to $3.7 million in 2005, up from $3.6 million in 2004 and $3.0 million in 2003.

Service charges on deposits in 2005 decreased by $93 thousand. This decrease is primarily attributable to increasing earnings credits provided to certain customer accounts, based on balances maintained. The earnings credits are tied to the 90-day treasury bill rate, which rose during 2005. The effect of increased earnings credits was partially offset by growth in deposit balances and related activity. Growth in service charges of $117 thousand in 2004 is attributable to the growth in the number of accounts. WMS revenue increased to $958 thousand in 2005, an increase of $36 thousand over the prior year and increased by $107 thousand in 2004. These increases are primarily the result of growth in assets under management. The increase in "other" income in 2005 of $122 thousand reflects higher reverse mortgage fees and fees due to increases in debit and credit card usage, partially offset by a decrease in Bank Owned Life Insurance (BOLI) income. The increase in "other" income in 2004 is attributed to growth in other services associated with an expanding customer base, increased BOLI income from investments made in 2003, as well as higher commissions and fees due to increased debit and credit card usage.

Table 5 Significant Components of Non-Interest Income

(Dollars in Thousands)	Year ended December 31, 2005	2004	2003	2005 compared to 2004 Amount Increase (Decrease)	2005 compared to 2004 Percent Increase (Decrease)	2004 compared to 2003 Amount Increase (Decrease)	2004 compared to 2003 Percent Increase (Decrease)
Service charges	$1,044	$1,137	$1,020	($93)	(8.2)%	$117	11.5%
Wealth Management Services	958	922	815	36	3.9	107	13.1
Other income							
Bank Owned Life Insurance	442	512	203	(70)	(13.7)	309	152.2
Customer banking fees and other charges	483	465	408	18	3.9	57	14.0
Other income	781	607	514	174	28.7	93	18.1
Total other income	1,706	1,584	1,125	122	7.7	459	40.8
Total	$3,708	$3,643	$2,960	$65	1.8%	$683	23.1%

Non-interest Expense

Table 6, Significant Components of Non-interest Expense, summarizes the amounts and changes in dollars and percentages. In 2005 non-interest expense increased 14.7% while average loans and deposits increased 24.6% and 13.5%, respectively. In 2004, non-interest expense increased 10.1%, while average loans and deposits increased 18.3% and 18.1%, respectively. The Bank's efficiency ratio improved from 54.68% in 2004 to 52.14% in 2005 and from 58.20% in 2003.

Table 6 Significant Components of Non-Interest Expense

(Dollars in Thousands)	Year ended December 31, 2005	2004	2003	2005 compared to 2004 Amount Increase (Decrease)	2005 compared to 2004 Percent Increase (Decrease)	2004 compared to 2003 Amount Increase (Decrease)	2004 compared to 2003 Percent Increase (Decrease)
Salaries and related benefits	$13,819	$11,954	$10,767	$1,865	15.6%	$1,187	11.0%
Occupancy and equipment	2,074	1,864	1,676	210	11.3	188	11.2
Depreciation and amortization	846	949	992	(103)	(1.1)	(43)	(4.3)
Data processing fees	1,330	1,210	1,039	120	9.9	171	16.5
Other expense							
Advertising	427	275	260	152	55.3	15	5.8
Professional services	809	726	684	83	11.4	42	6.1
Director expense	415	371	312	44	11.9	59	18.9
Other expense	2,778	2,271	2,087	507	22.3	184	8.8
Total other expense	4,429	3,643	3,343	786	21.6	300	9.0
Total	$22,498	$19,620	$17,817	$2,878	14.7%	$1,803	10.1%

For a discussion of the impact on non-interest expense of the adoption of SFAS No.123-R, see page 6, "Future Adoption of Accounting Standard."

In 2005, salaries and benefits costs increased by $1.9 million or 15.6%, primarily due to a higher number of full-time equivalent (FTE) employees, regular salary adjustments, an increase in bonus accrual and workers compensation insurance costs, as well as higher ESOP contributions. In 2005 there were expenses of $889 thousand for the Bank's Employee Stock Ownership and Savings Plan (ESOP), and $1.4 million for staff and officer incentive bonus plans. The number of FTE employees increased to 185, up from 167 at year-end 2004. The increase represents necessary expenses to support the growth of the Bank by hiring additional staff.

In comparing 2004 with 2003, salaries and benefits cost increased by $1.2 million or 11.0%, primarily due to annual merit pay increases, increased accruals for bonuses and ESOP contributions, as well as higher medical benefit and worker's compensation costs. The number of FTE employees increased by six from December 31, 2003 to 167 at December 31, 2004. In 2004, there were expenses of $1.2 million for the Bank's ESOP and $1.2 million for staff and officer incentive bonus plans.

The increases in 2005 and 2004 in occupancy and equipment costs of $210 thousand and $188 thousand, respectively, are largely due to annual rent increases in the branch and administration facilities, as well as the addition of new leases in June of 2005 and October 2005.

The decreases in 2005 and 2004 in depreciation and amortization expense of $103 thousand and $43 thousand, respectively, are primarily attributable to certain fixed assets becoming fully depreciated during the year.

In 2005, data processing costs were $1.3 million, an increase over 2004 of $120 thousand or 9.9 %. This increase is largely attributable to the greater number of accounts resulting from the growth of the Bank, the contractually stipulated price increases that are part of the Bank's long-term agreement with its data processing provider, and the increased use of internet banking and bill pay by the Bank's customers. In 2004, data processing expense increased by $171 thousand, and is attributable to the increase in the growth in the operations of the Bank.

Other non-interest expenses of $4.4 million represent a $786 thousand or 21.6% increase over 2004. The change includes increases in most expense categories, including advertising costs, contributions, travel, business meals, professional services, information technology, printing and postage. In 2004, other non-interest expenses increased by $300 thousand or 9.0%. These increases were due to the growth in activity of the Bank.

The Bank's efficiency ratio (the ratio of non-interest expense divided by the sum of non-interest income and net interest income) in 2005 of 52.14% improved over the prior year of 54.68%.

In January 2006, the Bank signed a lease on an office building in which to relocate its loan production, operations and administrative personnel. The Bank expects to occupy the space beginning in the third quarter of 2006. Rent is fixed at $57,698 per month for the first twelve months. Rental increases are fixed at 3% per year, thereafter. The annualized incremental cost of the new lease, after deducting the cost of the two properties being vacated, is approximately $300 thousand per year. In addition, related leasehold improvements, which are expected to total approximately $2 million, will be depreciated over fifteen years. Furniture, fixtures and equipment for the new site, which are expected to total approximately $500 thousand, will be depreciated over three-to-eight years.

Provision for Income Taxes

The Bank reported a provision for income taxes of $7.4 million, $5.8 million and $4.6 million for the years 2005, 2004 and 2003, respectively. These provisions reflect accruals for taxes at the applicable rates for Federal income and California State franchise taxes based upon reported pre-tax income, and adjusted for the beneficial effect of the Bank's investment in qualified municipal securities and life insurance products.

The Bank has not been subject to an alternative minimum tax (AMT). See Note 10 of the Notes to Financial Statements for additional discussion of Provision for Income Taxes.

FINANCIAL CONDITION

Investment Securities

The Bank maintains an investment securities portfolio to provide liquidity and 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 high investment yield. Table 7 shows the makeup of the securities portfolio at December 31, 2005 and 2004.

Table 7 Securities Investments

Type and Maturity Grouping (Dollars in thousands)	December 31, 2005 Principal Amount	Book Value*	Market Value	Average Yield	December 31, 2004 Principal Amount	Book Value*	Market Value	Average Yield
Held to maturity								
State and municipal								
Due within 1 year	$5,955	$5,966	$5,981	4.04%	$6,645	$6,688	$6,662	3.30%
Due after 1 but within 5 years	4,770	4,909	4,954	4.11	8,790	8,869	9,193	4.32
Due after 5 but within 10 years	3,780	4,014	4,043	3.54	6,485	6,912	7,003	3.41
Due after 10 years	3,325	3,471	3,307	3.36	3,595	3,780	3,602	3.41
Total	17,830	18,360	18,285	3.83	25,515	26,249	26,460	3.69
Corporate Bonds								
Due within 1 year	2,500	2,544	2,515	3.53	7,000	7,022	7,096	6.63
Due after 1 but within 5 years	1,000	991	1,034	7.57	4,500	4,572	4,700	5.26
Due after 5 but within 10 years	--	--	--	--	--	--	--	--
Due after 10 years	--	--	--	--	--	--	--	--
Total	3,500	3,535	3,549	4.68	11,500	11,594	11,796	6.09
Total held to maturity	21,330	21,895	21,834	3.97	37,015	37,843	38,256	4.44
Available for sale								
U.S. Treasury								
Due within 1 year	1,500	1,523	1,513	2.13	6,000	6,068	6,050	2.54
Due after 1 but within 5 years	2,500	2,603	2,549	2.38	4,000	4,283	4,230	2.28
Due after 5 but within 10 years	--	--	--	--	--	--	--	--
Due after 10 years	--	--	--	--	--	--	--	--
Total	4,000	4,126	4,062	2.29	10,000	10,351	10,280	2.44
U. S. government agencies								
Due within 1 year	8,548	8,583	8,463	2.39	17,360	17,433	17,512	4.22
Due after 1 but within 5 years	66,722	67,299	66,258	4.40	44,968	45,491	45,090	3.75
Due after 5 but within 10 years	2,288	2,315	2,252	5.21	1,274	1,279	1,258	4.93
Due after 10 years	5,774	5,775	5,742	5.19	--	--	--	--
Total	83,332	83,972	82,715	4.27	63,602	64,203	63,860	3.90
Total available for sale	87,332	88,098	86,777	4.18	73,602	74,554	74,140	3.70
Total	$108,662	$109,993	$108,611	4.14%	$110,617	$112,397	$112,396	3.95%

Interest income and yields on tax-exempt securities are not presented on a tax-equivalent basis. Maturities for securities are based on expected versus contractual maturities.

* Book value reflects cost, adjusted for accumulated amortization and accretion. No securities are less than investment grade.

The Bank's investment securities portfolio, consisting primarily of U.S. Treasuries, other U.S. government agencies, state and municipal securities, and corporate bonds, decreased $3.3 million or 3.0% in 2005. As loan demand grew in 2005, maturities of securities were replaced with loans. U.S. treasuries, representing 3.8% of the portfolio decreased by $6.2 million. U.S. government agency securities made up 76.1% of the portfolio and increased by $18.9 million. State and municipal securities decreased by $7.9 million and represented 16.9% of the portfolio and corporate bonds totaling $3.5 million or 3.3% of the portfolio decreased by $8.1 million in 2005. The weighted average maturity of the portfolio at December 31, 2005 was approximately forty-four months.

At December 31, 2003, the book value of investments in obligations of U. S. Treasury and other U. S. government agencies and corporations was $80.1 million, the book value of investments in obligations of state and municipal subdivisions was $30.5 million and the book value of investments in corporate bonds was $11.7 million.

Loans

Loans, net, increased by $108.7 million, which reflects increases in all loan categories. The Bank seeks to maintain a loan portfolio that is well balanced in terms of borrowers, collateral and maturities. Approximately 74% and 71% of the Bank's outstanding loans are secured by real estate at December 31, 2005 and 2004, respectively. The Bank's commercial real estate loan portfolio is composed primarily of term loans for which the primary source of repayment is cash flow from net operating income. Table 8 shows an analysis of loans by type.

Table 8 Loans Outstanding by Type at December 31

(Dollars in thousands)	2005	2004	2003	2002	2001
Commercial loans	$144,510	$120,006	$ 105,847	$ 85,192	$ 68,517
Real estate					
Commercial	282,564	250,326	196,703	187,384	161,136
Construction	112,116	81,549	44,471	41,736	27,305
Residential	36,304	30,692	28,052	29,824	28,363
Installment	111,167	94,384	75,808	66,019	40,928
Total loans	686,661	576,957	450,881	410,155	326,249
Allowance for loan losses	7,115	6,110	5,458	5,035	4,580
Net loans	$679,546	$570,847	$445,423	$405,120	$321,669

Table 9 shows a shift towards fixed rate loans within the portfolio in 2005 when compared to 2004. In 2005, the Bank's fixed rate loans were 45.1% of the portfolio, and the variable portion was 54.9%. The large majority of the variable rate loans are tied to independent indices (such as the Wall Street Journal prime rate or the Treasury Constant Maturities). Many of the fixed rate 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 five years.

Table 9 Loan Portfolio Maturity Distribution and Interest Rate Sensitivity

	December 31, 2005				December 31, 2004			
(Dollars in thousands)	Fixed Rate	Variable Rate	Total	Percent	Fixed Rate	Variable Rate	Total	Percent
Due within 1 year	$ 51,750	$145,083	$196,833	28.7%	$ 27,284	$139,083	$166,367	28.8%
Due after 1 but within 5 years	133,934	80,863	214,797	31.3	103,734	62,992	166,726	28.9
Due after 5 years	124,167	150,864	275,031	40.0	102,754	141,110	243,864	42.3
Total	$309,851	$376,810	$686,661	100.0%	$233,772	$343,185	$576,957	100.0%
Percentage	45.1%	54.9%	100.0%		40.5%	59.5%	100.0%	

Note: The "Due within 1 year" data includes demand loans, overdrafts and past due loans.

Allowance for Loan Losses

Credit risk is innate in the business of lending. As a result, the Bank maintains an allowance for loan losses to absorb losses inherent in the Bank's loan portfolio. This is maintained through periodic charges to earnings. These charges are shown in the Statement of Operations as provision for loan losses. All specifically identifiable and quantifiable losses are immediately charged off against the allowance. The balance of the Bank's allowance for loan losses is an estimate of the remaining losses inherent in the portfolio.

The allowance for loan losses to total loans at December 31, 2005 was 1.04% versus 1.06% at the end of 2004. At December 31, 2003, the allowance for loan losses to total loans was 1.21%. Based on the current conditions of the loan portfolio, management believes that the $7.1 million allowance for loan losses at December 31, 2005 is adequate to absorb losses inherent in the Bank's loan portfolio. No assurance can be given, however, that adverse economic conditions or other circumstances will not result in increased losses in the portfolio. Table 10 shows the activity in the allowance for loan losses for each of the years in the five-year period ended December 31, 2005. At December 31, 2005 and 2004 the Bank had no loans that were past due 90 days or otherwise non-performing.

Table 10 Allowance for Loan Losses at December 31

(Dollars in thousands)	2005	2004	2003	2002	2001
Beginning balance	$6,110	$5,458	$5,035	$4,580	$4,003
Provision charged to expense	1,541	934	685	577	619
Loans charged off					
Commercial	(362)	(6)	(146)	(33)	(37)
Construction	--	--	--	--	--
Real estate	--	--	--	--	--
Installment	(402)	(421)	(230)	(161)	(15)
Total	(764)	(427)	(376)	(194)	(52)
Loan loss recoveries					
Commercial	6	1	14	2	1
Construction	--	--	--	--	--
Real estate	--	--	--	--	--
Installment	222	144	100	70	9
Total	228	145	114	72	10
Net loans charged off	(536)	(282)	(262)	(122)	(42)
Ending balance	$7,115	$6,110	$5,458	$5,035	$4,580
Total loans outstanding at end of year, before deducting allowance for loan losses	$686,661	$576,957	$450,881	$410,155	$326,249
Average total loans outstanding during year	$640,726	$514,299	$434,908	$366,408	$291,717
Ratio of allowance for loan losses to total loans at end of year	1.04%	1.06%	1.21%	1.23%	1.40%

The Components of the Allowance for Loan Losses

As stated previously in "Critical Accounting Policies," the overall allowance consists of a specific allowance, an allowance factor, 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 where applicable.

The second component, the allowance factor, is an estimate of the probable inherent losses across the major loan categories in the Bank's loan portfolio. This analysis is based on loan grades by pool and current general economic and business conditions. This analysis covers the Bank's entire loan portfolio but excludes any loans that were analyzed individually for specific allowances as discussed above. The total amount allocated for this component is determined by applying loss estimation factors to outstanding loans.

The third component of the allowance for credit 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, economic trends, etc.

There are limitations to any credit risk grading process. The volume of loans makes it impractical to re-grade every loan every quarter. Therefore, it is possible that 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.

At December 31, 2005 the allowance for loan losses was $7.1 million consisting of a specific allowance of $1.1 million, an allowance factor of $5.2 million, and an economic allowance of $0.8 million. At December 31, 2004 the allowance for loan losses was $6.1 million consisting of a specific allowance of $1.0 million, an allowance factor of $4.5 million, and an economic allowance of $0.6 million.

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

	December 31, 2005		December 31, 2004		December 31, 2003		December 31, 2002		December 31, 2001	
(Dollars in thousands)	Allowance balance allocation	Loans as percent of total loans	Allowance balance allocation	Loans as percent of total loans	Allowance balance allocation	Loan as percent of total loans	Allowance balance allocation	Loans as percent of total loans	Allowance balance allocation	Loans as percent of total loans
Commercial	$2,510	21.1%	$2,320	20.8%	$2,288	23.4%	$1,584	20.9%	$1,322	21.0%
Construction	1,764	16.3	1,315	14.1	734	9.8	872	10.2	662	8.4
Real estate	1,435	46.4	1,260	48.7	1,319	44.2	1,577	45.9	1,860	51.2
Installment	1,406	16.2	1,215	16.4	1,117	22.6	1,002	23.0	736	19.4
Total allowance for loan losses	$7,115		$6,110		$5,458		$5,035		$4,580	
Total percent		100.0%		100.0%		100.0%		100.0%		100.0%

Deposits

Deposits increased by $76.1 million from December 31, 2005 as compared to December 31, 2004. Deposits are used to fund the Bank's interest earning assets. The Bank does not accept brokered deposits and has only a nominal amount of public funds. Tables 12 and 13 show the relative composition of the Bank's average deposits for the years 2005, 2004 and 2003, and the maturity groupings for the Bank's time deposits of $100,000 or more.

Table 12 Distribution of Average Deposits

	Year ended December 31, 2005		2004		2003	
(Dollars in thousands)	Amount	Percent	Amount	Percent	Amount	Percent
Demand	$185,873	26.3%	$164,881	26.5%	$138,214	26.2%
Interest checking	70,710	10.0	66,084	10.6	51,664	9.8
Savings	79,482	11.3	98,778	15.9	84,161	16.0
Money market	253,683	35.9	199,313	32.0	142,128	27.0
Time deposits						
Less than $100,000	39,683	5.6	37,392	6.0	39,756	7.5
$100,000 or more	76,619	10.9	55,797	9.0	70,984	13.5
Total time deposits	$116,302	16.5	93,189	15.0	110,740	21.0
Total Average Deposits	$706,050	100.0%	$622,245	100.0%	$526,907	100.0%

Note: Refer to Table 2 for the average amount of and the average rate paid on each deposit category.

Table 13 Maturities of Time Deposits of $100,000 or more at December 31

(Dollars in thousands)	December 31, 2005	2004	2003
Three months or less	$47,155	$30,538	$39,276
Over three months through six months	7,249	6,193	6,470
Over six months through twelve months	16,729	10,849	8,535
Over twelve months	20,795	21,140	17,239
Total	$91,928	$68,720	$71,520

Commitments

The following is a summary of the Bank's contractual commitments as of December 31, 2005.

Table 14 Contractual Obligations at December 31

	Payments due by period				
(Dollars in thousands)	**< 1 year**	**1-3 years**	**4-5 years**	**>5 years**	**Total**
Operating leases	$1,424	$2,697	$2,259	$2,482	$ 8,862
FHLB borrowings	--	10,000	--	--	10,000
Subordinated debt	--	--	--	5,000	5,000
Total	$1,424	$12,697	$2,259	$7,482	$23,862

Not reflected in the table above is the effect of a fifteen-year lease signed in January 2006, for office space. The Bank expects to occupy the space beginning in the third quarter of 2006. Rent is fixed at $57,698 per month for the first twelve months, with fixed increases of 3% per year thereafter.

The contract amount of loan commitments not reflected on the statement of condition was $226.8 million at December 31, 2005 and $184.6 million at December 31, 2004.

Capital Adequacy

As discussed in Note 14 of the Notes to Financial Statements, the Bank's capital ratios are above regulatory guidelines to be considered "well capitalized." In 2005, the Bank's risk based capital ratio improved from 11.37% at December 31, 2004 to 11.52% at December 31, 2005.

Liquidity

The goal of liquidity management is to provide adequate funds to meet both loan demand and unexpected deposit withdrawals. This goal is accomplished by maintaining an appropriate level of liquid assets, consistent with core deposit growth, and informal lines of credit to purchase funds from correspondent banks.

At year-end 2005, the Bank had approximately $40.7 million in cash, Federal funds sold and securities maturing within one year. The remainder of the securities portfolio of $90.2 million provides additional liquidity. At year-end 2004, the Bank had approximately $64.5 million in cash, Federal funds sold and securities maturing within one year. The remainder of the securities portfolio of $77.4 million provided additional liquidity. During 2005, the Bank's loan demand was strong, resulting in a decline in the Bank's one-year liquidity. The overall liquidity remains strong with total cash and securities equal to 15.6% of assets. Management expects to be able to meet the liquidity needs of the Bank during 2006 primarily through balancing loan growth with corresponding increases in deposits and borrowings. See discussion below for additional sources of liquidity for the Bank.

The Bank did utilize borrowings from FHLB and Federal funds lines during 2005. The Bank had outstanding balances of $31.0 million at December 31, 2005, as compared to $17.8 million at December 31, 2004.

During the year, the combination of 11.8% deposit growth and 19.0% gross loan growth resulted in a year-end loan-to-deposit ratio of 95.2% compared to 89.4% at December 31, 2004.

Management monitors the Bank's liquidity position daily, balancing loan fundings/payments with changes in deposit activity and overnight investments. The Bank's emphasis on local deposits at competitive rates, combined with its 9.3% equity capital base, provides a very stable funding base. The Bank also has unsecured lines of credit totaling $54.8 million with correspondent banks to purchase Federal funds. The Bank is a member of the Federal Home Loan Bank of San Francisco (FHLB), and has a line of credit (secured under terms of a blanket collateral agreement by a pledge of loans) for advances, $162.8 million ($131.8 million of which was available at December 31, 2005) at an interest rate that is determined daily. Borrowings under the line are limited to eligible collateral.

The Bank had undisbursed loan commitments of $226.8 million, including $103.9 million under lines of credit (these commitments are contingent upon customers maintaining specific credit standards), $54.3 million under revolving home equity lines, and $56.1 million under undisbursed construction loans. These commitments, to the extent used, are expected to be funded through repayment of existing loans and normal deposit growth.

Market Risk Management

Market risk is the risk of loss from adverse changes in market prices and rates. The Bank's market risk arises primarily from interest rate risk inherent in its loan and deposit functions. The objective for managing the assets and liabilities of the Bank is to maximize earnings while maintaining a high-quality portfolio of loans and investments and assuming only limited interest rate risk. The Asset and Liability Committee of the Board of Directors has overall responsibility for interest rate risk management policies. The Committee establishes and monitors guidelines to control the sensitivity of net interest income (NII) and regulatory Tier 1 capital (Capital) to changes in interest rates.

Activities in asset and liability management include, but are not limited to, lending, accepting deposits and investing in securities. Interest rate risk is the primary market risk associated with asset and liability management. Sensitivity of NII and Capital to interest rate changes arises when yields on loans and investments change in a different time frame or amount from that of rates on deposits and other interest-bearing liabilities. To mitigate interest rate risk, the structure of the statement of condition is managed with the objective of correlating the movements of interest rates on loans and investments with those of deposits. The asset and liability policy sets limits on the acceptable amount of change to NII and Capital in changing interest rate environments. The Bank uses simulation models to forecast NII and Capital.

Simulation of NII and Capital under various scenarios of increasing or decreasing interest rates is the primary tool used to measure interest rate risk. Using licensed software developed for this purpose, management is able to estimate the potential impact of changing rates. A simplified statement of condition is prepared on a quarterly basis as a starting point, using as inputs, actual loans, investments and deposits.

In the simulation of NII and Capital under various interest rate scenarios, the simplified statement of condition is processed against at least six interest rate change scenarios. In addition to a flat rate scenario, which assumes interest rates are unchanged, the six scenarios include three 100 basis point increases and three 100 basis point decreases. Each of these scenarios assumes that the change in interest rates is immediate and remains at the new levels.

Table 15 summarizes the effect on NII and Capital due to changing interest rates as measured against the flat rate scenario.

Table 15 Effect of Interest Rate Change on Net Interest Income and Capital

Changes in Interest Rates (in basis points)	Estimated change in NII (as percent of NII) at December 31, 2005	2004	Estimated change in capital (as percent of capital) at December 31, 2005	2004
up 300	4.9%	4.6%	2.7%	2.6%
up 200	3.3%	3.1%	1.8%	1.7%
up 100	1.6%	1.5%	0.9%	0.9%
unchanged	--	--	--	--
down 100	(2.7%)	(2.3%)	(1.5%)	(1.3%)
down 200	(5.6%)	(4.5%)	(3.1%)	(2.5%)
down 300	(8.5%)	N/A	(4.7%)	N/A

N/A - Not applicable as Federal funds rates cannot drop below zero.

The results in the table indicate that the Bank was modestly asset sensitive since NII increased under the increasing interest rate scenarios. The results are also well within the policy guidelines established by the Committee. Further, the results do not assume nor incorporate any action(s) which management might take to minimize any negative consequences of interest rate changes. Therefore, they are not intended to portray likely results but rather estimates of the impact of interest rate risk.

As with any simulation model or other method of measuring interest rate risk, certain limitations are inherent in the process. For example, although certain of the Bank's assets and liabilities may have similar maturities or repricing time frames, they may react differently to changes in market interest rates. In addition, the changes in interest rates on certain categories of either the Bank's assets or liabilities may precede or lag changes in market interest rates.

Also, the actual rates and timing of prepayments on loans and investment securities could vary significantly from the assumptions used in the various scenarios. Further, changes in US Treasury rates accompanied by a change in the shape of the yield curve could produce different results from those presented in the table. Accordingly, the results presented should not be relied upon as indicative of actual results in the event of changing market interest rates.

Interest rate sensitivity is a function of the repricing characteristics of the Bank's assets and liabilities. One aspect is the time frame within which the interest earning assets and interest bearing liabilities are subject to change in interest rates at repricing or maturity. An analysis of the repricing time frames is called a "gap" analysis because it shows the gap between the amounts of assets and liabilities repricing in each of several periods of time. Another aspect is the relative magnitude of the repricing for each category of interest earning asset and interest bearing liability given various changes in market rates. Gap analysis gives no indication of the relative magnitude of repricing. Interest rate sensitivity management focuses on the maturity of assets and liabilities and their repricing during periods of change in market rates. Interest rate sensitivity gaps are calculated as the difference between the amounts of assets and liabilities that are subject to repricing during various time periods.

Table 16 shows the Bank's repricing gaps as of December 31, 2005. Due to the limitations of gap analysis, as described above, the Bank does not generally use it in managing interest rate risk. Instead the Bank relies on the more sophisticated simulation model described above as its primary tool in measuring and managing interest rate risk.

Table 16 Interest Rate Sensitivity

	Maturing or Repricing					
(Dollars in thousands)	1-30 Days	31-90 Days	91-180 Days	181-365 Days	Over one year	Total
At December 31, 2005						
Interest Earning Assets						
Funds sold	$1,200	$ --	$ --	$ --	$ --	$1,200
Investment securities	--	2,478	3,869	12,138	90,187	108,672
Loans	210,751	18,009	23,451	25,386	401,949	679,546
Total	211,951	20,487	27,320	37,524	492,136	789,418
Interest Bearing Liabilities						
Transaction and savings deposits	395,001	--	--	--	--	395,001
Other borrowings	21,000	5,000	--	--	10,000	36,000
Time deposits less than $100,000	4,114	7,608	7,276	6,671	9,950	35,619
Time deposits $100,000 or more	14,153	33,105	7,523	15,997	21,150	91,928
Total	434,268	45,713	14,799	22,668	41,100	558,548
Demand Deposits	--	--	--	--	198,624	198,624
Sensitivity for period	(222,317)	(25,226)	12,521	14,856	252,412	$ 32,246
Sensitivity - cumulative	$(222,317)	$(247,543)	$(235,022)	$(220,166)	$32,246	

Deferred Compensation Obligations

The Bank maintains a nonqualified, unfunded deferred compensation plan for certain key management personnel. Under this plan, participating employees may defer compensation, which will entitle them to receive certain payments upon retirement, death, or disability. The plan provides for payments for fifteen years commencing upon retirement and reduced benefits upon early retirement, disability, or termination of employment. At December 31, 2005, the Bank's aggregate payment obligations under this plan totaled $1.4 million.

Off Balance Sheet Arrangements

The Bank makes commitments to extend credit in the normal course of business to meet the financing needs of its customers. For additional information, see Note 15 of the Notes to Financial Statements.

Borrowings

Short-term borrowings consist primarily of Federal funds purchased and borrowings from the Federal Home Loan Bank of San Francisco (FHLB).

Federal Home Loan Bank Borrowings
As of December 31, 2005, overnight borrowings with the FHLB totaled $21.0 million as compared to $17.8 million at December 31, 2004. Based on a blanket collateral agreement by a pledge of loans, at December 31, 2005 the FHLB line provided for maximum borrowings of approximately $162.8 million. At December 31, 2005 the Bank had an unused borrowing capacity with the FHLB of $131.8 million.

In July of 2005, the Bank executed a $10.0 million fixed-rate advance due July 18, 2008 from the FHLB at 4.23%.

Federal Funds Purchased from Correspondent Banks
The Bank has available unused unsecured lines of credit totaling $50.0 million for Federal funds transactions with correspondent banks. At December 31, 2005, Federal funds purchased were at zero.

Federal Reserve Line of Credit
The Bank also has available an unused line of credit with the Federal Reserve Bank totaling $4.8 million at December 31, 2005, secured by agency securities.

Subordinated Debt
On June 17, 2004, the Bank issued a 15-year, $5 million subordinated debenture through a pooled trust preferred program. The interest rate on the debentures is paid quarterly at the three-month LIBOR plus 2.48%. The debenture is subordinated to the claims of depositors and other creditors of the Bank. The principal is due on June 17, 2019.

Related Party Transactions

See Notes 3, 7, and 11 of the Notes to Financial Statements for discussion of the Bank's related party transactions.

Code of Ethics

Bank of Marin has adopted a Code of Ethics that applies to all employees, directors and officers, including the Bank's principal executive officer, principal financial officer and principal accounting officer. A copy of the Code of Ethics is available, without charge, upon written request to Corporate Secretary, Bank of Marin, P.O. Box 2039, Novato, CA 94948.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of Bank of Marin

We have audited the accompanying statements of condition of Bank of Marin (the "Bank") as of December 31, 2005 and 2004 and the related statements of operations, changes in stockholders' equity and cash flows for the years then ended. We have also audited management's assessment, included in the accompanying Management Report on Internal Control over Financial Reporting, that the Bank maintained effective internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Bank of Marin's management is responsible for these financial statements, maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on these financial statements, an opinion on management's assessment, and an opinion on the effectiveness of the Bank's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinion.

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

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Bank of Marin as of December 31, 2005 and 2004 and the results of its operations and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion management's assessment that Bank of Marin maintained effective internal control over financial reporting as of December 31, 2005, is fairly stated, in all material respects, based on criteria established in Internal Control - Integrated Framework issued by the COSO. Furthermore, in our opinion, Bank of Marin maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control - Integrated Framework issued by the COSO.

We have also audited the adjustments described in Note 1, Earnings per Share and Note 13, Stockholders' Equity that were applied to restate the 2003 financial statements resulting from the stock split in 2004 and the stock dividend in 2005. In our opinion, such adjustments are appropriate and have been properly applied.

/s/ Moss Adams LLP

Santa Rosa, California
March 10, 2006

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
Bank of Marin
Corte Madera, California

We have audited the accompanying statements of operations, stockholders' equity and cash flows of Bank of Marin for the year ended December 31, 2003 (prior to the restatement for a stock split in 2004 and a stock dividend in 2005, not presented herein). These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, such financial statements present fairly, in all material respects, the results of operations of the Bank and its cash flows for the year ended December 31, 2003 in conformity with accounting principles generally accepted in the United States of America.

/s/ Deloitte & Touche LLP

San Francisco, California
January 21, 2004

STATEMENT OF CONDITION
(Dollar amounts in thousands)

	December 31, 2005	December 31, 2004
Assets		
Cash and due from banks	$ 21,062	$ 29,499
Federal funds sold	1,200	---
Cash and cash equivalents	22,262	29,499
Investment securities		
Held to maturity, at amortized cost	21,895	37,843
Available for sale (at fair market value, cost $88,098 in 2005 and $74,554 in 2004)	86,777	74,140
Total investment securities	108,672	111,983
Loans, net of allowance for loan losses of $7,115 in 2005 and $6,110 in 2004	679,546	570,847
Bank premises and equipment, net	5,034	3,911
Interest receivable and other assets	24,935	20,854
Total assets	$840,449	$ 737,094
Liabilities and Stockholders' Equity		
Liabilities		
Deposits		
Non-interest bearing	$ 198,624	$ 170,385
Interest bearing		
Transaction accounts	75,652	68,259
Savings	319,349	306,067
Time	127,547	100,368
Total deposits	721,172	645,079
Federal funds purchased and Federal Home Loan Bank borrowing	31,000	17,800
Subordinated debenture	5,000	5,000
Interest payable and other liabilities	5,056	3,607
Total liabilities	762,228	671,486
Stockholders' Equity		
Common stock, no par value		
Authorized - 15,000,000 shares		
Issued and outstanding - 4,960,248 shares in 2005 and 4,609,685 shares in 2004	50,957	40,208
Retained earnings	28,030	25,640
Accumulated other comprehensive loss, net	(766)	(240)
Total stockholders' equity	78,221	65,608
Total liabilities and stockholders' equity	$ 840,449	$ 737,094

The accompanying notes are an integral part of these financial statements.

STATEMENT OF OPERATIONS

(In thousands, except per share data)

	Years ended December 31, 2005	2004	2003
Interest income			
Interest and fees on loans	$44,988	$33,140	$29,301
Interest on investment securities			
U. S. Treasury securities	155	324	518
Securities of U. S. Government agencies	2,930	2,257	1,018
Obligations of state and political subdivisions - tax exempt	808	1,012	954
Corporate debt securities and other	448	795	791
Interest on Federal funds sold	156	61	243
Total interest income	49,485	37,589	32,825
Interest expense			
Interest on interest bearing transaction deposits	276	257	207
Interest on savings and money market deposits	5,530	2,961	2,426
Interest on time deposits	3,396	1,968	2,534
Interest on borrowed funds	841	166	2
Total interest expense	10,043	5,352	5,169
Net interest income	39,442	32,237	27,656
Provision for loan losses	1,541	934	686
Net interest income after provision for loan losses	37,901	31,303	26,970
Non-interest income			
Service charges on deposit accounts	1,044	1,137	1,020
Wealth Management Services	958	922	815
Other income	1,706	1,584	1,125
Total non-interest income	3,708	3,643	2,960
Non-interest expense			
Salaries and related benefits	13,819	11,954	10,767
Occupancy and equipment	2,074	1,864	1,676
Depreciation and amortization	846	949	992
Data processing	1,330	1,210	1,039
Other expense	4,429	3,643	3,343
Total non-interest expense	22,498	19,620	17,817
Income before provision for income taxes	19,111	15,326	12,113
Provision for income taxes	7,374	5,808	4,640
Net income	$ 11,737	$ 9,518	$ 7,473
Net income per common share*			
Basic	$2.39	$1.99	$1.62
Diluted	$2.23	$1.85	$1.51
Dividends declared per common share	$0.20	$0.40	$0.00

* Restated for the 5% stock dividend declared in April 2005 and for the 3-for-2 stock split declared in April 2004.

The accompanying notes are an integral part of these financial statements.

STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
(Dollar amounts in thousands)

	Common Stock		Retained	Accumulated Other Comprehensive Income (Loss),	Unearned ESOP	
	Shares	Amount	Earnings	Net of taxes	Shares	Total
Balance at Dec. 31, 2002	2,757,393	$31,969	$14,662	$551	$(65)	$47,117
Comprehensive income:						
Net income	---	---	7,473	---	---	7,473
Other comprehensive income						
Net change in unrealized gain (loss) on available for sale securities (net of tax liability of $215)	---	---	---	(296)	---	(296)
Comprehensive income	---	---	7,473	(296)	---	7,177
Stock options exercised	48,958	757	---	---	---	757
Tax benefit from exercised stock options	---	198	---	---	---	198
Stock issued on 5% stock dividend declared Apr. 10	138,461	4,162	(4,180)	---	---	(18)
Stock issued in payment of director fees	9,242	281	---	---	---	281
Change in unearned ESOP shares	---	---	---	---	65	65
Balance at Dec. 31, 2003	2,954,054	$37,367	$17,955	$255	$---	$55,577
Comprehensive income:						
Net income	---	---	9,518	---	---	9,518
Other comprehensive income						
Net change in unrealized gain (loss) on available for sale securities (net of tax benefit of $358)	---	---	---	(495)	---	(495)
Comprehensive income	---	---	9,518	(495)	---	9,023
Stock options exercised	126,901	1,875	---	---	---	1,875
Tax benefit from exercised stock options	---	652	---	---	---	652
3-for-2 stock split declared April 15	1,519,714	---	(9)	---	---	(9)
Cash dividend paid June 1	---	---	(1,824)	---	---	(1,824)
Stock issued in payment of director fees	9,016	314	---	---	---	314
Balance at Dec. 31, 2004	4,609,685	$40,208	$25,640	$(240)	$---	$65,608
Comprehensive income:						
Net income	---	---	11,737	---	---	11,737
Other comprehensive income						
Net change in unrealized gain (loss) on available for sale securities (net of tax benefit of $381)	---	---	---	(526)	---	(526)
Comprehensive income	---	---	11,737	(526)	---	11,211
Stock options exercised	106,709	1,351	---	---	---	1,351
Tax benefit from exercised stock options		680	---	---	---	680
Stock issued on 5% dividend declared on April 14	233,025	8,340	(8,357)	---	---	(17)
Cash dividends paid	---	---	(990)	---	---	(990)
Stock issued in payment of director fees	10,829	378	---	---	---	378
Balance at Dec. 31, 2005	4,960,248	$50,957	$28,030	$(766)	$---	$78,221

The accompanying notes are an integral part of these financial statements.

STATEMENT OF CASH FLOWS
(In thousands)

	Years ended December 31,		
	2005	2004	2003
Cash Flows from Operating Activities:			
Net income	$11,737	$ 9,518	$ 7,473
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses	1,541	934	686
Compensation payable in common stock	410	344	281
Amortization and accretion of investment security premiums, net	821	1,570	1,107
Depreciation and amortization	846	949	992
Net change in operating assets and liabilities:			
Interest receivable	(621)	(362)	19
Interest payable	89	(25)	(81)
Other assets	(2,762)	(3,468)	(495)
Other liabilities	1,709	1,046	(2,605)
Total adjustments	2,033	988	(96)
Net cash provided by operating activities	13,770	10,506	7,377
Cash Flows from Investing Activities:			
Purchase of securities held-to-maturity	(1,205)	(5,363)	(14,277)
Purchase of securities available-for-sale	(33,630)	(38,545)	(87,479)
Proceeds from paydowns/maturity of:			
Securities held-to-maturity	15,915	9,350	6,972
Securities available-for-sale	19,511	42,878	34,578
Proceeds from sales of securities	992	---	---
Purchase of bank owned life insurance policies	(698)	---	(10,000)
Loans originated and principal collected, net	(110,240)	(126,358)	(40,989)
Additions to premises and equipment	(1,969)	(352)	(949)
Net cash used in investing activities	(111,324)	(118,390)	(112,144)
Cash Flows from Financing Activities:			
Net increase in deposits	76,093	60,963	98,087
Proceeds from stock options exercised	2,031	2,527	955
Net increase in Federal funds purchased and Federal Home Loan Bank borrowings	13,200	17,800	---
Dividends paid in cash	(1,007)	(1,824)	---
Subordinated debt issued	---	5,000	---
Other	---	(9)	(18)
Net cash provided by financing activities	90,317	84,457	99,024
Net decrease in cash and cash equivalents	(7,237)	(23,427)	(5,743)
Cash and cash equivalents at beginning of year	29,499	52,926	58,669
Cash and cash equivalents at end of year	$22,262	$29,499	$52,926
Supplemental disclosure of cash flow information:			
Cash paid for interest	$9,911	$5,319	$5,250
Cash paid for income taxes	$7,400	$5,599	$4,822

The accompanying notes are an integral part of these financial statements.

NOTES TO FINANCIAL STATEMENTS

December 31, 2005
(In thousands, except share and per-share data)

Note 1: Summary of Significant Accounting Policies

Nature of Operations: The Bank of Marin (the Bank) is a California state chartered bank. The Bank operates eight branches in Marin County and two in southern Sonoma County, California. The Bank's primary source of revenue is interest from providing loans to customers, who are predominately professionals, small and middle-market businesses, and middle and high-income individuals who work and/or reside in Marin and southern Sonoma counties. The accounting and reporting policies of the Bank conform with generally accepted accounting principles and general practice within the banking industry. A summary of the more significant policies follows.

Investment Securities are classified as "held to maturity," "trading securities" or "available for sale." Investments classified as held to maturity are those that the Bank has the ability and intent to hold until maturity and are reported at cost, adjusted for the amortization or accretion of premiums or discounts. Investments classified as trading securities are reported at fair value, with unrealized gains and losses included in earnings. Investments classified as available for sale are reported at fair value, with unrealized gains and losses, net of related tax, if any, reported as a separate component of comprehensive income and included in stockholders' equity until realized. For the majority of the Bank's securities, fair values are determined based upon quoted prices for similar securities.

At each financial statement date, management assesses each investment to determine if impaired investments are temporarily impaired or if the impairment is other than temporary based upon the positive and negative evidence available. Evidence evaluated includes, but is not limited to, industry analyst reports, credit market conditions and interest rate trends. A decline in the market value of any security below cost that is deemed other than temporary results in a charge to earnings and the corresponding establishment of a new cost basis for the security. Premiums and discounts are amortized or accreted over the life of the related security as an adjustment to yield using the effective interest method. Dividend and interest income are recognized when earned. Realized gains and losses for securities are included in earnings and are derived using the specific identification method for determining the cost of securities sold.

Loans are reported at the principal amount outstanding net of deferred fees and the allowance for loan losses. Interest income is accrued daily using the simple interest method. Loans are placed on nonaccrual status when management believes that there is serious doubt as to the collection of principal or interest, or when they become contractually past due by 90 days or more with respect to principal or interest, except for loans that are both well secured and in the process of collection. When loans are placed on nonaccrual status, any accrued but uncollected interest is reversed from current-period interest income and additional income is recorded only as payments are received. Loan origination and commitment fees, offset by certain direct loan origination costs, are deferred and amortized as yield adjustments over the contractual lives of the related loans.

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 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, the Bank considers the Bank's past loan loss experience, 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. The allowance for loan losses is based on estimates and ultimate losses may vary from current estimates.

The Bank's method for assessing the appropriateness of the allowance includes specific allowances for identified problem loans, an allowance factor for pools of credits and allowances for changing environmental factors (e.g., portfolio trends, concentration of credit, growth, economic factors, etc.). Allowances for identified problem loans are based on specific analysis of individual credits. Loss estimation factors for loan pools are based on analysis of local economic factors applicable to each loan pool. Due to the Bank's minimal historic losses, loss estimation factors are based only in part on the previous historical loss experience for each pool. 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.

The Bank considers a loan as impaired when it is probable the Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement. For loans determined to be impaired, the extent of the impairment is measured based on the present value of expected future cash flows discounted at the loan's original effective interest rate or based on the loan's observable market price or the fair value of the collateral, if the loan is collateral dependent. When the measure of the impaired loan is less than the recorded investment in the loan, the impairment is recorded through an allocation of the allowance for loan losses. The Bank's Directors' Loan Committee reviews the adequacy of the allowance for loan losses at least quarterly, to include consideration of the relative risks in the portfolio and current economic conditions. The allowance is adjusted based on that review if, in the judgment of the Loan Committee and management, changes are warranted.

Transfers of Financial Assets The Bank has entered into certain participation agreements with other organizations. The Bank accounts for these transfers of financial assets as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Bank, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Bank does not maintain effective control over the transferred assets through either (a) an agreement to repurchase them before their maturity or (b) the ability to otherwise cause the holder to return specific assets. No gain or loss has been recognized by the Bank on the sale of these participation interests.

Bank Premises and Equipment consist of leasehold improvements, furniture, fixtures and equipment and are stated at cost, less accumulated depreciation and amortization, which are calculated on a straight-line basis over the estimated useful life of the property or the term of the lease (if less). Furniture and fixtures are depreciated over 8 years and equipment is generally depreciated over 3 to 20 years. Leasehold improvements are amortized over the terms of the leases or their estimated useful lives, whichever is shorter. When assets are sold or otherwise disposed of, the cost and related accumulated depreciation or amortization are removed from the accounts and any resulting gain or loss is recognized in income for the period. The cost of maintenance and repairs is charged to expense as incurred.

Employee Stock Ownership Plan (ESOP) and Related Debt The Bank accounts for shares acquired by its ESOP in accordance with the guidelines established by the American Institute of Certified Public Accountants Statement of Position 93-6, "Employers' Accounting for Employee Stock Ownership Plans." The Bank recognizes compensation cost equal to the fair value of the ESOP shares during the periods in which they become committed to be released. To the extent that the fair value of the Bank's ESOP shares committed to be released differ from the cost of those shares, the differential is charged or credited to equity. The ESOP is externally leveraged and, as such, the ESOP debt is recorded as a liability and interest expense is recognized on such debt. The ESOP shares not yet committed to be released are accounted for as a reduction in stockholders' equity.

Income Taxes reported in the financial statements are computed based on an asset and liability approach. The Bank recognizes the amount of taxes payable or refundable for the current year, and deferred tax assets and liabilities for the future tax consequences that have been recognized in the financial statement or tax returns. The measurement of tax assets and liabilities is based on the provisions of enacted tax laws.

Cash and Cash Equivalents include cash and due from banks and federal funds sold, which have an original maturity of 90 days or less at the time of purchase.

The Bank is required to maintain reserves with the Federal Reserve Bank of San Francisco equal to a percentage of its reservable deposits. Reserve balances that were required by the Federal Reserve Bank were zero and $10.5 million for December 31, 2005 and 2004, respectively, and are reported in cash and due from banks on the balance sheet.

Earnings per share are based upon the weighted average number of common shares outstanding during each year. The following table shows weighted average basic shares, potential common shares related to stock options, and weighted average diluted shares. Basic earnings per share are based upon the weighted average number of common shares outstanding during each period. Diluted earnings per share are based upon the weighted average number of common shares and potential common shares outstanding during each period. Earnings per share and share amounts for all periods have been retroactively adjusted for the 3-for-2 stock split in 2004 and the 5% stock dividend in 2005.

	2005	2004	2003
Weighted average basic shares outstanding	4,918,059	4,774,176	4,612,610
Add: Potential common shares related to stock options	335,749	368,735	331,371
Weighted average diluted shares outstanding	5,253,808	5,142,911	4,943,981

The number of antidilutive shares not included in the calculation of diluted earnings per shares were 61,350, 14,250 and 17,366 at December 31, 2005, 2004 and 2003, respectively.

Stock-Based Compensation In December 2002 the Bank adopted the disclosure provisions of Statement of Financial Accounting Standards (SFAS) No. 148 - Accounting for Stock-Based Compensation - Transition and Disclosure, which amends SFAS No. 123 - Accounting for Stock-Based Compensation. This Statement provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. It also amends the disclosure requirements to require prominent disclosure about the method of accounting for stock-based employee compensation and the effect of the method used on reported results.

The Bank accounts for stock-based awards for its plans under APB Opinion No. 25 - Accounting for Stock Issued to Employees - under which no stock-based compensation cost has been recognized in net income, as all options granted under these plans had an exercise price equal to the market value of the underlying common stock on the date of grant. Had compensation cost for these plans been determined in accordance with SFAS No. 123, the Bank's net income and earnings per share would have been reduced to the pro forma amounts shown in the following table. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model.

(Dollars in thousands, except per share amounts)	2005	2004	2003
Net income as reported	$11,737	$9,518	$7,473
Stock-based compensation expense, net of taxes	(833)	(905)	(959)
Pro forma net income	$10,904	$8,613	$6,514
Earnings per share			
As reported (basic)	$2.39	$1.99	$1.62
As reported (diluted)	2.23	1.85	1.51
Pro forma (basic)	2.22	1.80	1.41
Pro forma (diluted)	2.08	1.68	1.32
Weighted-average fair value of options granted during the year	$11.61	$11.74	$7.44
Assumptions used in weighted-average fair value			
Risk-free interest rate	4.38%	4.05%	4.00%
Expected dividend yield	1.13%	1.22%	0.00%
Expected life in years	9	8	8
Expected price volatility	22.87%	29.96%	28.83%

In December 2004, the Financial Accounting Standards Board adopted SFAS No. 123-R, which requires recognition for stock-based compensation expense in the Bank's financial statements beginning in the first quarter of 2006. Historically, option grants have vested 20% immediately and 20% on each anniversary of the grant for four years. The Bank changed the vesting in the fourth quarter of 2005 such that all grants on or after January 1, 2006 will vest 20% on each anniversary of the grant for five years. The Bank expects to adopt the requirements of SFAS No. 123-R prospectively in January 2006 and estimates the impact, after giving effect to the change in vesting described above, to be a reduction to net income of approximately $150 thousand to $200 thousand per quarter.

Comprehensive Income for the Bank includes net income reported on the statement of operations and changes in the fair value of its available for sale investments reported as a component of stockholders' equity.

Segment Information The Bank's two operating segments include the traditional community banking activities provided through its ten branches and its Wealth Management Services. The activities of these two segments are monitored and reported by Bank management as separate operating segments. The accounting policies of the segments are the same as those described in this note. The Bank evaluates segment performance based on total segment revenue and does not allocate expenses between the segments. Wealth Management Services revenues were $958 thousand in 2005, $922 thousand in 2004 and $815 thousand in 2003, which are included in non-interest income in the statement of operations. The revenues of the community banking segment are reflected in all other income lines in the statement of operations.

Reclassifications Certain amounts in prior years' financial statements have been reclassified to conform with the current presentation. These reclassifications have no effect on previously reported net income.

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

Note 2: Investment Securities

The amortized cost and fair market value of investment securities at December 31, 2005 and 2004 consisted of the following:

		Gross Unrealized		Fair
(In thousands)	Amortized Cost	Gains	Losses	Market Value
2005 Held to maturity				
Oblig. of state & political subdivisions	$18,360	$115	$(190)	$18,285
Corporate debt securities and other	3,535	43	(29)	3,549
	21,895	158	(219)	21,834
2005 Available for sale				
U. S. Treasury Securities	4,126	---	(64)	4,062
Securities of U.S. Government Agencies	83,972	17	(1,274)	82,715
	88,098	17	(1,338)	86,777
Total	$109,993	$175	$(1,557)	$108,611
2004 Held to maturity				
Oblig. of state & political subdivisions	$26,249	$472	$(261)	$26,460
Corporate debt securities and other	11,594	213	(11)	11,796
	37,843	685	(272)	38,256
2004 Available for sale				
U. S. Treasury Securities	10,351	6	(77)	10,280
Securities of U.S. Government Agencies	64,203	130	(473)	63,860
	74,554	136	(550)	74,140
Total	$112,397	$821	$(822)	$112,396

The amortized cost and estimated market value of investment securities at December 31, 2005 by contractual maturity are shown below. Expected maturities will 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.

	December 31, 2005			
	Held to maturity		Available for sale	
(In thousands)	Amortized Cost	Fair Market Value	Amortized Cost	Fair Market Value
Within one year	$8,510	$8,496	$10,106	$9,975
After one but within five years	5,900	5,988	69,903	68,808
After five years through ten years	4,014	4,043	2,315	2,252
After ten years	3,471	3,307	5,774	5,742
Total	$21,895	$21,834	$88,098	$86,777

During 2005, the Bank sold one security due to deterioration of the issuer's credit worthiness. The proceeds from the sale totaled $992 thousand and resulted in a gain of $1 thousand. For the years ended December 31, 2004 and 2003 the Bank did not sell any of its investment securities, and accordingly, did not recognize any gains or losses. At December 31, 2005, investment securities carried at $20.5 million were pledged with the Federal Reserve Bank: $4.7 million to secure the Bank's Treasury, Tax and Loan account and trust deposits, $4.9 million to provide collateral for potential future borrowings to meet unusual short-term liquidity needs, and $10.9 million to secure the Bank's public fund deposits. In addition, at December 31, 2005 $684 thousand was pledged to provide collateral for the Bank's interest rate swap.

Investment securities with unrealized losses are summarized and classified according to the duration of the loss period as follows:

December 31, 2005				
	≤ 12 continuous months		> 12 continuous months	
(In thousands)	Fair value	Unrealized loss	Fair value	Unrealized loss
Held-to-maturity				
Obligations of state & political subdivisions	$4,454	$(22)	$ 3,850	$(168)
Corporate debt securities and other	---	---	2,014	(29)
	4,454	(22)	5,864	(197)
Available for sale				
U. S. Treasury Securities	---	---	4,063	(64)
Securities of U. S. Government Agencies	39,744	(514)	37,285	(760)
	39,744	(514)	41,348	(824)
Total temporarily impaired securities	$44,198	$(536)	$47,212	$(1,021)

December 31, 2004				
	≤ 12 continuous months		> 12 continuous months	
(In thousands)	Fair value	Unrealized loss	Fair value	Unrealized loss
Held-to-maturity				
Obligations of state & political subdivisions	$5,634	$(261)	$---	$ ---
Corporate debt securities and other	2,081	(11)	---	---
	7,715	(272)	---	---
Available for sale				
U. S. Treasury Securities	9,272	(77)	---	---
Securities of U. S. Government Agencies	42,222	(473)	---	---
	51,494	(550)	---	---
Total temporarily impaired securities	$59,209	$(822)	$---	$---

Management periodically evaluates each investment security in an unrealized loss position to determine if the impairment is temporary or other than temporary. Included are forty-one securities at December 31, 2005 and twenty-seven securities at December 31, 2004 with fair values of $91.4 million and $59.2 million, respectively, and unrealized losses of $1.6 million and $822 thousand, respectively. Management has determined that no investment security is other than temporarily impaired. This temporary impairment is attributable to general changes in short-term interest rates as measured by the U.S. Treasury yield curve.

Note 3: Loans

The majority of the Bank's loan activity is with customers located in California, primarily in the counties of Marin and southern Sonoma. Although the Bank has a diversified loan portfolio, a large portion of the loans are for commercial property, and many of the Bank's loans are secured by real estate in Marin and Sonoma County. Approximately 74% and 71% of the loans are secured by real estate at December 31, 2005 and 2004 respectively.

Outstanding loans by type, net of deferred loan fees of $2.8 million and $2.0 million at December 31, 2005 and 2004, respectively, are as follows:

(In thousands)	2005	2004
Commercial loans	$144,510	$120,006
Real estate		
Commercial	282,564	250,326
Construction	112,116	81,549
Residential	36,304	30,692
Installment	111,167	94,384
Total loans	686,661	576,957
Less - Allowance for loan losses	(7,115)	(6,110)
Net Loans	$679,546	$570,847

At December 31, 2005 and 2004, the Bank had no loans that were past due greater than 90 days.

At December 31, 2005, the Bank's FHLB line of credit and advances were secured under terms of a blanket collateral agreement by a pledge of certain qualifying collateral, including loans.

The Bank has, and expects to have in the future, banking transactions in the ordinary course of its business with directors, officers, principal stockholders and their associates. These transactions, including loans, are granted on substantially the same terms, including interest rates and collateral on loans, as those prevailing at the same time for comparable transactions with others. Likewise, these transactions do not involve more than the normal risk of collectibility or present other unfavorable features.

An analysis of net loans to related parties for the years ended December 31, 2005 and 2004, is as follows:

(In thousands)	2005	2004
Balance at beginning of year	$2,497	$1,730
New loans to related parties	2,384	1,044
Repayments	(254)	(277)
Balance at end of year	$4,627	$2,497

The undisbursed commitment to related parties as of December 31, 2005, was $1.9 million.

Note 4: Allowance for Loan Losses

Activity in the allowance for loan losses for the three years in the period ended December 31 follows:

(In thousands)	2005	2004	2003
Beginning balance	$6,110	$5,458	$ 5,035
Provision for loan loss charged to expense	1,541	934	685
Loans charged off	(764)	(427)	(376)
Loan loss recoveries	228	145	114
Ending balance	$7,115	$ 6,110	$ 5,458
Total loans outstanding at end of year, before deducting allowance for loan losses	$686,661	$ 576,957	$ 450,881
Average total loans outstanding during the year	$640,726	$ 514,299	$ 434,908
Ratio of allowance for loan losses to total loans at end of year	1.04%	1.06%	1.21%

Loans classified as nonaccrual amounted to $0 at December 31, 2005 and 2004.

At December 31, 2005, 2004 and 2003 the Bank had no impaired loans. The average recorded investment in impaired loans was $214 thousand for the year ended December 31, 2005 and zero for the years ended December 31, 2004 and 2003.

Note 5: Bank Premises and Equipment

A summary of Bank premises and equipment at December 31 follows:

(In thousands)	2005	2004
Leasehold improvements	$ 6,438	$ 5,276
Furniture and equipment	6,845	6,038
	13,283	11,314
Accumulated depreciation and amortization	(8,249)	(7,403)
Bank premises and equipment, net	$ 5,034	$3,911

The amount of depreciation and amortization was $846 thousand, $949 thousand and $992 thousand for the three years in the period ended December 31, 2005, 2004 and 2003, respectively.

Note 6: Bank Owned Life Insurance

The Bank has purchased life insurance policies on the lives of certain officers in the Bank and intends to use the policies ($11.9 million cash surrender value at December 31, 2005 and $10.7 million cash surrender value at December 31, 2004) to finance employee benefit programs. The investment in the Bank owned life insurance (BOLI) policies are reported in "interest receivable and other assets" at the cash surrender value of the policies. The carrying value includes both the Bank's original premiums invested in the life insurance policies and the accumulated accretion of policy income since inception of the policies. Income of $442 thousand in 2005 and $512 thousand in 2004 was recognized on the life insurance policies and is reported in "other non-interest income."

Note 7: Deposits

Time deposits in denominations of $100,000 or greater were $91.9 million and $68.7 million at December 31, 2005 and 2004, respectively. Interest on these deposits was $2.8 million, $1.6 million and $2.0 million in 2005, 2004 and 2003, respectively. Scheduled maturities of these deposits at December 31, 2005 follows:

(In thousands)	2006	2007	2008	2009	2010	Thereafter	Total
Scheduled maturities of time deposits	$70,778	$10,833	$2,807	$5,076	$2,434	$---	$91,928

The Bank accepts deposits from shareholders, directors and employees in the normal course of business, and the terms are comparable to those with non-affiliated parties.

Note 8: Borrowings

Purchased Funds Short-term debt at December 31, 2005 and 2004 included overnight borrowings from the Federal Home Loan Bank ("FHLB") in the amount of $21.0 million and $17.8 million, respectively. Short-term borrowing available to the Bank of $162.8 million consists of a line of credit for advances with the FHLB secured under terms of a blanket collateral agreement by a pledge of loans. At December 31, 2005 the Bank had an unused capacity with the FHLB of $131.8 million. The Bank also has unused unsecured lines of credit totaling $50.0 million with correspondent banks for overnight borrowings. At December 31, 2005, interest rates on lines of credit with correspondent banks ranged from 3.38% to 5.13%.

Federal Home Loan Bank Advance During the third quarter of 2005, the Bank obtained a Federal Home Loan Bank advance for $10.0 million. Each month, the Bank pays an annualized fixed rate of interest of 4.23% on the three-year advance. The principal of $10.0 million is due in its entirety upon maturity in the third quarter of 2008.

Federal Reserve Line of Credit The Bank also has available an unused line of credit with the Federal Reserve Bank totaling $4.8 million at 5.25% at December 31, 2005, secured by agency securities.

Subordinated Debt On June 17, 2004 the Bank issued a 15-year, $5.0 million subordinated debenture through the pooled trust preferred program of FTN Financial Capital market and Keefe, Bruyette and Woods, which matures on June 17, 2017. The Bank has the right to redeem the debenture, in whole or in part, at the redemption price at principal amounts in multiples of $1.0 million on any interest payment date on or after June 17, 2009. The interest rate on the debentures changes quarterly and is paid quarterly at the three-month LIBOR plus 2.48%. The rate at December 31, 2005 was 6.98%. The debenture is subordinated to the claims of depositors and other creditors of the Bank.

Borrowings at December 31, 2005 and 2004 are summarized as follows:

	2005			2004		
(In thousands)	Carrying Value	Average Balance	Average Rate	Carrying Value	Average Balance	Average Rate
Overnight borrowings	$21,000	$11,498	3.04%	$17,800	$2,805	1.74%
FHLB three-year advance	10,000	4,575	4.23	---	---	---
Subordinated debenture	5,000	5,000	5.97	5,000	2,705	4.32

The maximum amount outstanding at any month end for overnight borrowings was $39.4 million and $18.8 million, during 2005 and 2004, respectively.

Note 9: Benefit Plans

In 2003 the Bank established an Officer Deferred Compensation Plan, which allows key executive officers designated by the Board of Directors of the Bank to defer up to 80% of their salary and 100% of their annual bonus. Amounts deferred earn interest at a rate set annually by the Board of Directors. The interest rate was set at 7.25% for 2005, 7.00% for 2004 and 6.00% for the period from September 1, 2003 to December 31, 2003. The Bank's deferred compensation obligation of $1.4 million and $722 thousand at December 31, 2005 and 2004, respectively, is included in "interest payable and other liabilities."

The Bank also established a Split Dollar Plan and a Survivor Income Plan in 2003 for officers designated by the Board of Directors. Death benefits are provided under the specific terms of these plans. The Bank has purchased life insurance policies on the designated officers in connection with these plans. The expense recognized under this plan totaled $56 thousand and $52 thousand for the years ended December 31, 2005 and 2004, respectively.

The Bank's 401(k) Plan commenced in May 1990 and is available to all employees. Under the Plan employees can defer up to 50% of their base pay, up to the maximum amount allowed by the Internal Revenue Code. The Bank will match 50% of each participant's contribution up to a maximum match of $4 thousand annually. Employer contributions totaled $338 thousand, $306 thousand and $267 thousand for the years ended December 31, 2005, 2004 and 2003, respectively.

In 1995 the Plan was amended to include an employee stock ownership component and was renamed the Bank of Marin Employee Stock Ownership and Savings Plan. Under the terms of the Plan, as amended, a portion of the Bank's profits, as determined by the Board of Directors, is contributed to the Plan each year either in common stock or in cash for the purchase of Bank of Marin stock. For the years ended December 31, 2005, 2004 and 2003 the Bank contributed $889 thousand, $754 thousand and $653 thousand, respectively. Generally, cash dividends on the Bank's stock held by the Plan are used to purchase additional shares in the open market. All shares of the Bank's stock held by the Plan are included in the calculations of basic and diluted earnings per share. At December 31, 2005 the Bank had a $1.0 million, 26-month revolving line of credit at prime plus 1/4% from an unaffiliated community bank. At December 31, 2005 the balance on the line was zero.

Contributions to the Plan for both the matching contribution and for the purchase of Bank of Marin stock are included in "salaries and benefits." Employer contributions vest at a rate of 20% per year over a five-year period.

Note 10: Income Taxes

The current and deferred components of the income tax provision for each of the three years ended December 31, 2005 are as follows:

In thousands	2005	2004	2003
Current tax provision			
Federal	$6,113	$ 4,791	$3,465
State	2,220	1,828	1,405
Total current	8,333	6,619	4,870
Deferred tax (benefit)/liability			
Federal	(769)	(619)	(145)
State	(190)	(192)	(85)
Total deferred	(959)	(811)	(230)
Total income tax provision	$7,374	$5,808	$4,640

Income taxes recorded directly to comprehensive income are not included above. These income tax benefits/(liabilities) relating to changes in the unrealized gains and losses on available for sale investment securities amounted to $381 thousand, $358 thousand and ($215) thousand in 2005, 2004 and 2003, respectively.

The following table shows the tax effect of the Bank's cumulative temporary differences as of December 31:

(In thousands)	2005	2004
Deferred tax assets:		
Allowance for loan losses	$3,426	$2,895
Depreciation	381	304
State franchise tax	185	123
Deferred compensation	697	423
Net unrealized loss on securities available for sale	582	174
	5,271	3,919
Deferred tax liabilities:		
Loan origination costs	(164)	(179)
Net deferred tax asset	$5,107	$3,740

Based upon the level of historical taxable income and projections for further taxable income over the periods during which the deferred tax assets are deductible, management believes it is more likely than not the Bank will realize the benefit of the deferred tax assets.

The effective tax rate of the Bank for 2005, 2004 and 2003 differs from the current Federal statutory income tax rate as follows:

	2005	2004	2003
Federal statutory income tax rate	35.0%	35.0%	34.0%
Increase (decrease) due to:			
California franchise tax, net of federal tax benefit	6.9	6.9	7.2
Tax exempt interest on municipal securities	(1.6)	(2.3)	(2.8)
Other	(1.7)	(1.7)	(0.1)
	38.6%	37.9%	38.3%

Note 11: Commitments and Contingencies

The Bank rents certain premises and equipment under long-term non-cancellable operating leases expiring at various dates through the year 2021. At December 31, 2005 the approximate minimum future commitments payable under non-cancellable contracts for leased premises are as follows:

(In thousands)	2006	2007	2008	2009	2010	Thereafter	Total
Operating leases	$1,424	$1,345	$1,352	$1,246	$1,013	$2,482	$8,862

Rent expense included in "occupancy" totaled $1.5 million, $1.3 million and $1.2 million in 2005, 2004 and 2003, respectively.

Not reflected in the table above is the effect of a fifteen-year lease signed in January 2006, for office space. The Bank expects to occupy the space beginning in the third quarter of 2006. Rent is fixed at $57,698 per month for the first twelve months, with fixed increases of 3% per year thereafter.

The Bank leases one branch facility from a current member of the Bank's Board of Directors at current market prices. Rental payment to the Director totaled $122 thousand, $120 thousand and $116 thousand for the years ended December 31, 2005, 2004 and 2003, respectively.

The Bank is party to legal actions which arise from time to time as part of the normal course of its business. The Bank believes, after consultation with legal counsel, that it has meritorious defenses in these actions, and that the liability, if any, will not have a material adverse effect on the financial position, results of operations, or cash flows of the Bank.

Note 12: Fair Value of Financial Instruments

The carrying amounts and fair values of the Bank's financial instruments at December 31, 2005 and 2004 follows:

	2005		2004	
(In thousands)	Carrying Amounts	Fair Value	Carrying Amounts	Fair Value
Financial assets				
Cash and cash equivalents	$22,262	$22,262	$ 29,499	$ 29,499
Investment securities	108,672	108,611	111,983	112,396
Loans, net	679,546	675,189	570,847	574,016
Accrued interest receivable	3,934	3,934	3,312	3,312
Financial liabilities				
Deposits	721,172	720,810	645,079	645,109
Federal funds purchased	21,000	21,000	17,800	17,800
Federal Home Loan Bank borrowings	10,000	9,832	---	---
Subordinated debenture	5,000	5,000	5,000	5,000
Accrued interest payable	396	396	307	307

The following methods and assumptions were used to estimate the fair value of each class of financial instruments:

Cash and Cash Equivalents - Cash and cash equivalents are valued at their carrying amounts because of the short-term nature of these instruments.

Investment Securities - Investment securities are valued at the quoted market prices. See Note 2 for further analysis.

Loans - Loans with variable interest rates are valued at the current carrying value, because these loans are regularly adjusted to market rates. The fair value of fixed rate loans with remaining maturities in excess of one year is estimated by discounting the future cash flows using current rates at which similar loans would be made to borrowers with similar credit ratings for the same remaining maturities.

Accrued Interest Receivable and Payable - The accrued interest receivable and payable balance approximates its fair value.

Deposits - The fair value of non-interest bearing deposits, interest bearing transaction accounts and savings accounts is the amount payable on demand at the reporting date. The fair value of time deposits is estimated by discounting the future cash flows using current rates offered for deposits of similar remaining maturities.

Federal Funds Purchased - The balance represents its fair value due to the short-term nature of these borrowings.

Federal Home Loan Bank Borrowings - The fair value is estimated by discounting the future cash flows using current rates offered for similar borrowings.

Subordinated Debenture - The balance represent its fair value as it has a variable interest rate.

Commitments - The fair value of commitments represents the carrying amount of the related unamortized loan fees and is not material.

Note 13: Stockholders' Equity

On April 14, 2005 and April 10, 2003, the Board of Directors declared 5% stock dividends. Cash was paid in lieu of issuing fractional shares.

During the third quarter of 2005, the Bank implemented a quarterly dividend program and as a result paid a ten cents per common share cash dividend in each of the third and fourth quarters of 2005, totaling $495 thousand in each quarter. The cash dividends were recorded as a reduction to retained earnings.

A 3-for-2 stock split was paid on May 24, 2004 to shareholders of record on May 19, 2004. Additionally, the Board declared a one-time special cash dividend of $.40 per post-split share payable on June 1, 2004 to shareholders of record on May 27, 2004.

Earnings per share amounts and information with respect to stock options have been restated for all years presented to reflect the stock dividends and stock split.

The Bank has stock option plans for full-time, salaried officers and employees who have substantial responsibility for the successful operation of the Bank. Terms of the plans provide for the issuance of up to 1,062,504 shares of common stock for these officers and employees. Options are issued at the fair market value of the stock at the date of grant. Options expire ten years from the grant date, and vest over a four year period. Terms of the plans also provide for the issuance of up to 181,871 shares for non-employee directors. These options expire seven years from the grant date, and vest over a four year period. A summary of the status of the Bank's stock option plans at December 31, 2005, 2004 and 2003 and changes for the years then ended is presented in the following table. The 2003 information has been restated to reflect the 3-for-2 stock split that occurred in 2004. The 2004 and 2003 information has been restated for the 5% stock dividend that occurred in 2005.

	2005		2004		2003	
	Shares	Weighted Avg. Exercise Price	Shares	Weighted Avg. Exercise Price	Shares	Weighted Avg. Exercise Price
Outstanding at beg. of year	763,974	$15.10	856,373	$12.61	872,798	$11.76
Granted	92,125	$34.52	105,295	$28.43	82,314	$19.10
Exercised	(109,534)	$12.34	(176,416)	$10.63	(78,592)	$9.63
Cancelled/forfeited	(4,465)	$23.26	(21,278)	$17.74	(20,147)	$14.11
Outstanding at end of year	742,100	$17.87	763,974	$15.10	856,373	$12.61
Exercisable at end of year	560,050	$14.61	565,198	$12.99	601,926	$11.66

A summary of the options outstanding and exercisable by price range as of December 31, 2005 is presented in the following table.

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Outstanding	Weighted Avg. Remaining Contractual Life	Weighted Avg. Exercise Price	Exercisable	Weighted Avg. Exercise Price
$0.00 - $5.00	3,484	0.1	$4.52	3,484	$4.52
$5.01 - $10.00	23,542	0.9	$5.98	23,542	$5.98
$10.01 - $15.00	377,339	3.7	$12.13	375,255	$12.11
$15.01 - $20.00	120,454	6.2	$16.65	83,496	$16.53
$20.01 - $25.00	27,685	6.4	$21.03	16,610	$21.03
$25.01 - $30.00	84,188	8.3	$27.68	33,673	$27.68
$30.01 - $35.00	95,958	9.4	$34.10	21,155	$33.88
$35.01 - $40.00	9,450	9.0	$35.91	2,835	$35.73
	742,100	5.4	$17.87	560,050	$14.61

Under California state banking laws, payment of dividends is restricted to the lesser of retained earnings or the amount of undistributed net profits from the three most recent fiscal years. Under this restriction, approximately $25.9 million of the retained earnings balance was available for payment of dividends as of December 31, 2005.

Note 14: Regulatory Matters

The Bank is subject to various regulatory capital requirements administered by the federal and California banking agencies. The Federal Deposit Insurance Corporation (FDIC) has adopted risk-based capital regulations, which assign risk weightings to bank assets and “off-balance sheet” items (such as loan commitments). Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary actions by the FDIC that, if undertaken, could have a material effect on the Bank’s financial statements. The regulations require the Bank to maintain minimum amounts and ratios (set forth in the following table) of Total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined) and of Tier 1 capital (as defined) to average assets (as defined). Management believes, as of December 31, 2005 and 2004, that the Bank met all capital adequacy requirements to which it is subject.

As of December 31, 2005, the most recent notification from the FDIC categorized the Bank as “well capitalized” under the regulatory framework for prompt corrective action. There are no conditions or events since the notification that management believes have changed the Bank’s category. The Bank’s actual capital amounts and ratios as of December 31, 2005 and 2004, are presented in the following table.

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
(In thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2005						
Total Capital (to risk-weighted assets)	$91,556	11.52%	≥$63,561	≥8.0%	≥$79,452	≥10.0%
Tier 1 Capital (to risk-weighted assets)	$78,988	9.94%	≥$31,781	≥4.0%	≥$47,671	≥ 6.0%
Tier 1 Capital (to average assets)	$78,988	9.38%	≥$33,673	≥4.0%	≥$42,092	≥ 5.0%
As of December 31, 2004						
Total Capital (to risk-weighted assets)	$77,328	11.37%	≥$54,388	≥8.0%	≥$67,986	≥10.0%
Tier 1 Capital (to risk-weighted assets)	$65,849	9.69%	≥$27,194	≥4.0%	≥$40,791	≥ 6.0%
Tier 1 Capital (to average assets)	$65,849	8.98%	≥$29,332	≥4.0%	≥$36,665	≥ 5.0%

Note 15: Financial Instruments with Off-Balance Sheet Risk

The Bank makes commitments to extend credit in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit in the form of loans or through standby letters of credit. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amount does not necessarily represent future cash requirements.

The Bank is exposed to credit loss, in the event of nonperformance by the borrower, in the contract amount of the commitment. The Bank uses the same credit policies in making commitments as it does for on-balance-sheet instruments and evaluates each customer’s creditworthiness on a case-by-case basis. The amount of collateral obtained if deemed necessary by the Bank is based on management’s credit evaluation of the borrower. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment, and real property. The contract amount of loan commitments not reflected on the statement of condition was $226.8 million at December 31, 2005. This amount included $103.9 million under commercial lines of credit (these commitments are contingent upon customers maintaining specific credit standards), $54.3 million under revolving home equity lines and $56.1 million under undisbursed construction loans, at rates ranging from 3.88% to 18.00%. The Bank has set aside an allowance for losses in the amount of $454 thousand for these commitments, which is recorded in “interest payable and other liabilities.” Approximately 57% of the commitments expire in 2006 with approximately 43% expiring between 2007 and 2016.

Note 16: Derivative Financial Instruments and Hedging Activities

In the second quarter of 2005, Bank of Marin entered into an interest-rate swap, primarily as an asset/liability management strategy, in order to hedge the change in the fair value of a long-term fixed-rate loan due to changes in interest rates. Such hedges allow the Bank to offer long-term fixed rate loans to customers without assuming the interest rate risk of a long-term asset by swapping the Bank’s fixed-rate interest stream for a floating-rate interest stream tied to the one-month LIBOR. Such modification of the interest characteristics of the loan protects the Bank against an adverse effect on earnings and the net interest margin due to fluctuating interest rates.

The Bank's derivative contract is designated as a fair value hedge and qualifies for fair value hedge accounting in accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended. The interest rate swap is carried on the balance sheet at its fair value in other assets (when the fair value is positive) and in other liabilities (when the fair value is negative). As a result of interest rate fluctuations, the hedged loan will gain or lose market value. In a fair value hedging strategy, the effect of this unrealized gain or loss will generally be offset by gain or loss on the interest rate swap derivative linked to the hedged loan. Changes in the fair value of the derivative and the offsetting changes in the fair value of the hedged loan are recorded in "other non-interest income" and net to zero, as the hedge was 100% effective for year ended December 31, 2005. The full change in value of the derivative was included in the assessment of hedge effectiveness.

The interest rate swap held by the Bank is scheduled to mature in June of 2020. Information on the interest rate swap at December 31, 2005 was as follows:

(in thousands)	At December 31, 2005
Notional or contractual amount	$7,828
Credit risk amount (1)	$123
Estimated net fair value	$123

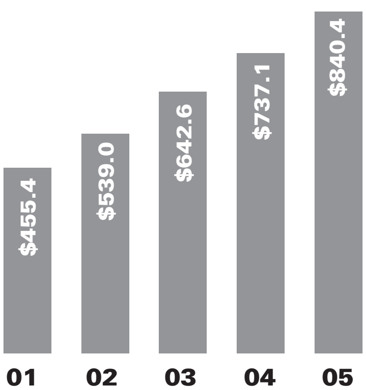
	Year ended December 31, 2005
Weighted average pay rate	4.59%
Weighted average receive rate	3.70%
Gain (loss) on designated derivative contract	$123
Increase (decrease) in value of designated loans	(123)
Net gain (loss) on derivatives used to hedge loans recorded in income	$0

(1) Credit risk represents the amount of unrealized gain included in derivative assets which is subject to counterparty credit risk. It reflects the effect of master netting agreements.

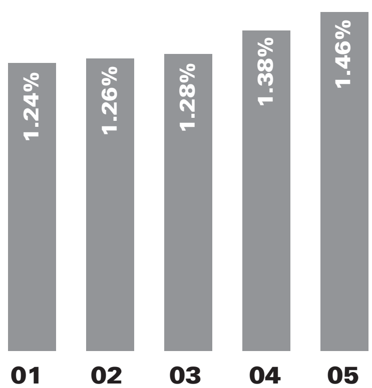
SELECTED FINANCIAL DATA (in thousands except per share)

At December 31	2001	2002	2003	2004	2005	04/05 % change
Total assets	$ 455,417	$ 539,025	$ 642,607	$ 737,094	$ 840,449	14.0%
Total loans	326,249	410,155	450,881	576,957	686,661	19.0%
Total deposits	411,818	486,029	584,116	645,079	721,172	11.8%
Total stockholders' equity	40,601	47,117	55,577	65,608	78,221	19.2%
Equity-to-assets ratio	8.9%	8.7%	8.6%	8.9%	9.3%	

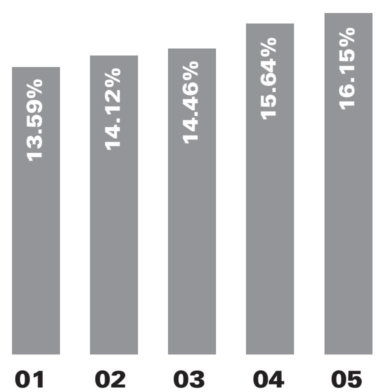
For year ended December 31	2001	2002	2003	2004	2005	04/05 % change
Net interest income	$ 21,456	$ 25,522	$ 27,656	$ 32,237	$39,442	22.4%
Provision for possible loan losses	619	577	686	934	1,541	65.0%
Non-interest income	1,873	2,318	2,960	3,643	3,708	1.8%
Non-interest expense	14,428	17,125	17,817	19,620	22,498	14.7%
Net income	5,148	6,242	7,473	9,518	11,737	23.3%
Net income per share (diluted)*	1.11	1.30	1.51	1.85	2.23	20.5%
Cash dividend payout ratio	0%	0%	0%	20.1%	8.4%	



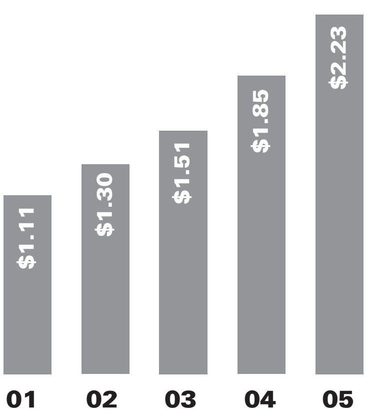
Total Assets (in millions)



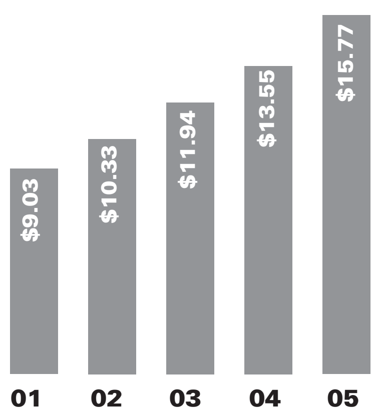
Return on Assets



Return on Equity



Net Income Per Share (diluted)*



Book Value Per Share*

*Restated for stock dividends declared April 2001, 2002, 2003 and 2005, and a 3-for-2 stock split declared April 2004.

DIVIDEND INFORMATION, STOCK PRICE AND MARKETPLACE DESIGNATION

In April 2005 the Board of Directors declared a 5% stock dividend. Additionally, the Board of Directors declared cash dividends of ten cents per common share in August 2005 and in November 2005. In April 2004, the Board of Directors declared a 3-for-2 stock split and in June 2004 declared a cash dividend of $0.40 per share.

During 2005 there were 2,002 trades at prices ranging from a high of $37.48 to a low of $30.80. In 2004 there were 1,999 trades at prices ranging from a high of $38.76 to a low of $25.30.

Bank of Marin common stock trades on the NASDAQ SmallCap Market under the symbol BMRC. There were 774 holders of record of the Bank's common stock as of February 28, 2006.