

# SECURITIES AND EXCHANGE COMMISSION

## FORM S-1/A

General form of registration statement for all companies including face-amount certificate companies [amend]

Filing Date: **1999-07-27**  
SEC Accession No. **0001047469-99-028704**

([HTML Version](#) on [secdatabase.com](#))

### FILER

#### **PACIFIC COMMUNITY BANKING GROUP**

CIK: **1057159** | IRS No.: **330778067** | State of Incorporation: **CA** | Fiscal Year End: **1231**  
Type: **S-1/A** | Act: **33** | File No.: **333-76403** | Film No.: **99670850**  
SIC: **6022** State commercial banks

Mailing Address  
23332 MILL CREEK DRIVE  
SUITE 230  
LAGUNA HILLS CA 92653

Business Address  
23332 MILL CREEK DR  
STE 230  
LAGUNA HILLS CA 92653  
9494604540

REGISTRATION NO. 333-76403

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

AMENDMENT NO. 4  
TO  
FORM S-1

REGISTRATION STATEMENT  
UNDER  
THE SECURITIES ACT OF 1933

PACIFIC COMMUNITY BANKING GROUP  
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

<TABLE>			
<S>	<C>	<C>	<C>
CALIFORNIA	6712		33-0778067
(State or other jurisdiction of incorporation or organization)	(Primary Standard Industrial Classification Code Number)		(I.R.S. Employer Identification No.)
</TABLE>			

23332 MILL CREEK DRIVE, SUITE 230  
LAGUNA HILLS, CALIFORNIA 92653  
(949) 460-4540

(Address, including zip code, and telephone number, including area code, of  
registrant's principal executive offices)

E. LYNN CASWELL  
CHAIRMAN AND CHIEF EXECUTIVE OFFICER  
23332 MILL CREEK DRIVE, SUITE 230  
LAGUNA HILLS, CALIFORNIA 92653  
(949) 460-4540

(Name, address, including zip code, and telephone number, including area code,  
of agent for service)

COPIES OF ALL COMMUNICATIONS TO BE SENT TO:

<TABLE>			
<S>	<C>	<C>	<C>
HENRY M. FIELDS, ESQ. ELLEN R. MARSHALL, ESQ. CHARLES S. KAUFMAN, ESQ. MORRISON & FOERSTER LLP 555 WEST FIFTH STREET LOS ANGELES, CALIFORNIA 90013-1024 (213) 892-5200	LOREN P. HANSEN, ESQ. KNECHT & HANSEN 1301 DOVE STREET, SUITE 900 NEWPORT BEACH, CALIFORNIA 92660 (949) 851-8070		PAUL H. IRVING, ESQ. MANATT, PHELPS & PHILLIPS, LLP 11355 WEST OLYMPIC BOULEVARD LOS ANGELES, CALIFORNIA 90064 (310) 312-4000
</TABLE>			

APPROXIMATE DATE OF COMMENCEMENT OF PROPOSED SALE TO THE PUBLIC:

As soon as practicable after the effective date of this registration statement.

If any of the securities being registered on this form are to be offered on a  
delayed or continuous basis pursuant to Rule 415 under the Securities Act of  
1933, check the following box. / /

If this Form is filed to register additional securities for an offering pursuant  
to Rule 462(b) under the Securities Act, please check the following box and list  
the Securities Act registration statement number of the earlier effective  
registration statement for the same offering. / /

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. / /

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. / /

-----  
 CALCULATION OF REGISTRATION FEE

<TABLE>  
 <CAPTION>

TITLE OF EACH CLASS OF SECURITIES TO BE REGISTERED	AMOUNT TO BE REGISTERED (1)	PROPOSED MAXIMUM OFFERING PRICE PER SHARE (1)	PROPOSED MAXIMUM AGGREGATE OFFERING PRICE (2)	AMOUNT OF REGISTRATION FEE (2)
	<C>	<C>	<C>	<C>
Common Stock, no par value.....	4,305,000 shares	\$16.00	\$68,887,500	\$19,150.73 (3)

</TABLE>

- (1) Includes 562,500 shares which the Underwriters have options to purchase to cover, over-allotments, if any.
- (2) Estimated solely for purpose of calculating the amount of the registration fee. This estimate is made in accordance with Rule 457(c) under the Securities Act of 1933, as amended.
- (3) Previously paid with the initial filing on April 16, 1999 and with Amendment No. 3 filed on July 6, 1999.

-----  
 SUBJECT TO COMPLETION, PRELIMINARY PROSPECTUS DATED JULY , 1999

PROSPECTUS

THE INFORMATION IN THIS PROSPECTUS IS NOT COMPLETE AND MAY BE CHANGED. WE MAY NOT SELL THESE SECURITIES UNTIL THE REGISTRATION STATEMENT FILED WITH THE SECURITIES AND EXCHANGE COMMISSION BECOMES EFFECTIVE. THIS PROSPECTUS IS NOT AN OFFER TO SELL THESE SECURITIES AND WE ARE NOT SOLICITING AN OFFER TO BUY THESE SECURITIES IN ANY STATE WHERE THE OFFER OR SALE IS NOT PERMITTED OR WOULD BE UNLAWFUL PRIOR TO REGISTRATION OR QUALIFICATION UNDER THE SECURITIES LAWS OF ANY SUCH STATE.

3,750,000 SHARES

[LOGO]

COMMON STOCK

Pacific Community Banking Group is a recently formed company that will own two Southern California community banks, The Bank of Hemet and Valley Bank.

We are offering shares to be sold in the offering. The selling shareholders identified in this prospectus are selling shares. The public offering price is \$ per share. This is our initial public offering, and no market currently exists for our shares. The offering price may not reflect the market price of our shares after this offering. Pacific Community Banking Group will not receive any of the proceeds from the sale of shares by the selling shareholders.

<TABLE>  
 <CAPTION>

	PER SHARE	TOTAL
	-----	-----
<S>	<C>	<C>
Public Offering Price.....		
Underwriting Discounts.....		
Proceeds, before expenses, to Pacific Community Banking Group.....		
Proceeds, before expenses, to the selling shareholders....		

</TABLE>

We have granted the underwriters the right to purchase an additional 562,500 shares from us to cover over-allotments. The underwriters expect to deliver shares of common stock to purchasers on or about July 30, 1999.

-----  
Proposed Trading Symbol:

Nasdaq National Market--PCBG  
-----

THIS INVESTMENT INVOLVES A HIGH DEGREE OF RISK. YOU SHOULD PURCHASE SHARES ONLY IF YOU CAN AFFORD A COMPLETE LOSS OF YOUR INVESTMENT. PLEASE REFER TO "RISK FACTORS" COMMENCING ON PAGE 6.

NEITHER THE SECURITIES AND EXCHANGE COMMISSION NOR ANY STATE SECURITIES COMMISSION HAS APPROVED OR DISAPPROVED OF THESE SECURITIES OR DETERMINED IF THIS PROSPECTUS IS TRUTHFUL OR COMPLETE. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE. PLEASE NOTE THAT THESE SHARES ARE NOT SAVINGS OR DEPOSIT ACCOUNTS OR OTHER OBLIGATIONS OF ANY BANK OR NONBANK SUBSIDIARY OF ANY OF THE PARTIES, AND THE SHARES ARE NOT INSURED BY THE FEDERAL DEPOSIT INSURANCE CORPORATION, THE BANK INSURANCE FUND OR ANY OTHER GOVERNMENTAL AGENCY.

SUTRO & CO. INCORPORATED  
FRIEDMAN BILLINGS RAMSEY  
WEDBUSH MORGAN SECURITIES  
RAGEN MACKENZIE INCORPORATED

JULY , 1999

[ARTWORK]

[Map of Southern California labeled "Facility Locations." The map shows the location in Riverside and San Bernardino counties of the main branches, local branches and administrative/data processing facilities of The Bank of Hemet and Valley Bank, and the loan production office of Valley Bank. A larger scale inset map of California shows the region covered by the facility map.]

PERSONS PARTICIPATING IN THIS OFFERING MAY ENGAGE IN TRANSACTIONS WHICH STABILIZE, MAINTAIN OR OTHERWISE AFFECT THE PRICE OF COMMON STOCK OF THE COMPANY INCLUDING STABILIZING BIDS, SYNDICATE COVERING TRANSACTIONS OR THE IMPOSITION OF PENALTY BIDS. FOR A DISCUSSION OF THESE ACTIVITIES, PLEASE REFER TO "UNDERWRITING." SUCH TRANSACTIONS MAY BE EFFECTED ON THE NASDAQ NATIONAL MARKET OR OTHERWISE. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

PROSPECTUS SUMMARY

YOU SHOULD READ THE FOLLOWING SUMMARY TOGETHER WITH THE MORE DETAILED INFORMATION AND THE FINANCIAL STATEMENTS APPEARING ELSEWHERE IN THIS PROSPECTUS. THIS PROSPECTUS CONTAINS FORWARD-LOOKING STATEMENTS THAT INVOLVE RISKS AND UNCERTAINTIES. PACIFIC COMMUNITY BANKING GROUP'S ACTUAL RESULTS MAY DIFFER SIGNIFICANTLY FROM THE RESULTS DISCUSSED IN THE FORWARD-LOOKING STATEMENTS. FACTORS THAT MIGHT CAUSE SUCH A DIFFERENCE INCLUDE, BUT ARE NOT LIMITED TO, THOSE DISCUSSED IN THE SECTION ENTITLED "RISK FACTORS" BEGINNING ON PAGE 6. PACIFIC COMMUNITY BANKING GROUP

A group of individual investors led by E. Lynn Caswell, an experienced California community banker, formed our company in 1997. Our goal is to become the preeminent financial services company for independent banks in high growth areas of Southern California, commencing with Riverside and San Bernardino counties. In pursuit of that goal, and in connection with this offering, we have acquired two community banks headquartered in Riverside county, California--The Bank of Hemet and Valley Bank. The service areas of these two banks overlap. We plan to combine their operations and increase market share in the area they now serve. We then plan to launch a new community bank in Orange county, California.

The Bank of Hemet and Valley Bank primarily serve Riverside and San Bernardino counties, a region commonly known as the "Inland Empire." The Inland Empire will include the fastest growing U.S. primary metropolitan statistical area between the years 1993 to 2005, according to a 1996 report of the U.S. Department of Commerce. The department projected that population in the area will grow 32.4% during that period.

Prior to these acquisitions, our company had no operations. As of March 31, 1999, we had \$1.3 million in invested capital.  
PROFILES OF THE BANK OF HEMET AND VALLEY BANK

<TABLE>  
<CAPTION>

	THE BANK OF HEMET	VALLEY BANK
<S>	<C>	<C>
Total assets at March 31, 1999.....	\$254 million	\$87 million
Headquarters.....	Hemet, California	Moreno Valley, California
Offices.....	Main branch and 5 branches in Riverside county	Main branch and 6 branches in Riverside and San Bernardino counties and 2 loan production offices, one in Moreno Valley and one in Portland, Oregon
Principal service areas.....	Riverside, San Bernardino, Orange,	Riverside and San Bernardino

	Los Angeles and San Diego counties	counties, Portland, Oregon and southern Washington State
Loan portfolio.....	High percentage of commercial real estate loans	High percentage of real estate loans, with a significant portion in Small Business Administration loans
Active subsidiaries.....	Data processing subsidiary	none

</TABLE>

1

BUSINESS STRATEGY

Our business strategy is to:

- develop a banking presence primarily in high-growth areas of Southern California through the acquisition of strongly performing, well regarded community banks;
- operate most acquired banks as separate subsidiaries to retain their boards of directors and the goodwill of the communities they serve;
- consolidate operations of acquired banks which serve overlapping market areas;
- form community banks in areas of Southern California that may have lost many of their independent community banks through consolidation, merger, acquisition and regulatory action;
- cross-sell services of our constituent banks;
- realize efficiencies by combining functions like financial administration, data processing, insurance, bonding, employee benefits and contracts for services; and
- take advantage of the combined size and diversity of our constituent banks to access capital at lower costs.

We believe that banking customers value doing business with locally managed institutions that can provide a full service commercial banking relationship, understand customers' financial needs and have the flexibility to customize products and services to meet those needs. We also believe that banks are better able to build successful customer relationships by affiliating with a holding company that provides cost effective administrative support services while promoting bank autonomy and individualized service.

Our principal executive offices are located at 23332 Mill Creek Drive, Suite 230, Laguna Hills, California 92653. Our telephone number is (949) 460-4540, and our facsimile number is (949) 458-2086. We were incorporated under the laws of California in October 1997.

2

THE OFFERING

<TABLE>

<S>	<C>
Common stock offered by Pacific Community Banking Group.....	shares(1)
Common stock offered by the selling shareholders.....	shares
Common stock to be outstanding after this offering.....	shares(2)
Use of proceeds.....	For working capital and general corporate purposes, and to pay expenses of the offering and the business combination of Pacific Community Banking Group, The Bank of Hemet and Valley Bank. For a more detailed discussion of how we expect to use these proceeds, please refer to "Use of Proceeds" on page 13. We will not receive any proceeds from the sale of stock by the selling shareholders.

</TABLE>

-----  
(1) Excludes shares of common stock issuable upon exercise of the underwriter's over-allotment option.

(2) Based on the number of shares outstanding as of , 1999. This number includes 1,460,000 shares of preferred stock convertible into 119,828 shares of common stock, and 3,840,937 shares to be issued in the business combination of Pacific Community Banking Group, The Bank of Hemet and Valley Bank. This number excludes (i) 1,308,000 warrants to purchase shares of common stock at an exercise price of \$ per share, and (ii) options to purchase 470,000 shares of common stock at an exercise price of \$ share. This number assumes that the Underwriters will not exercise their over-allotment option.

Following the offering, the directors and executive officers of Pacific Community Banking Group will hold approximately shares, or % of the shares that will be outstanding. In addition, the directors and executive officers of Pacific Community Banking Group will hold approximately 483,000 warrants exercisable at \$ per share, or 36.95% of the warrants that will be outstanding.

## SUMMARY FINANCIAL INFORMATION

Pacific Community Banking Group was formed in October 1997, for the sole purpose of acquiring community banking organizations. The following tables set forth summary financial data of Pacific Community Banking Group, The Bank of Hemet and Valley Bank. It includes pro forma financial data for the combined companies. The historical information presented below at or for the periods ended December 31, 1998 and 1997 is derived from the financial statements of the respective companies, which have been audited by their independent public accountants, as indicated in their reports thereon included in this prospectus. The information at or for the periods ended March 31, 1999 and 1998 is unaudited, and in the opinion of management of the respective companies gives effect to all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of the financial information. The unaudited pro forma information at or for the year ended December 31, 1998 and the period March 31, 1999 are derived from the unaudited pro forma combined financial information contained elsewhere in this prospectus and are based on the assumptions stated in connection with that information. The data should be read in conjunction with "Management's Discussion and Analysis of Financial Condition" for each of the companies and their audited financial statements appearing in this prospectus.

<TABLE>  
<CAPTION>

	PRO FORMA COMBINED					
	AT OR FOR THE THREE MONTHS ENDED		AT OR FOR THE YEAR ENDED	AT OR FOR INCEPTION (OCTOBER 17, 1997) TO DECEMBER 31, 1997	AT OR FOR THE YEAR ENDED	AT OR FOR THE THREE MONTHS ENDED
	MARCH 31, 1999	MARCH 31, 1998	DECEMBER 31, 1998	DECEMBER 31, 1997	DECEMBER 31, 1998	MARCH 31, 1999
	(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)					
	(UNAUDITED)				(UNAUDITED)	
<S>	<C>	<C>	<C>	<C>	<C>	<C>
PACIFIC COMMUNITY BANKING GROUP						
RESULTS OF OPERATIONS:						
Interest income.....	\$ --	\$ --	\$ --	\$ --	\$ 25,597	\$ 6,141
Interest expense.....	--	--	--	--	10,623	2,501
Net interest income.....	--	--	--	--	14,974	3,640
Provision for loan losses.....	--	--	--	--	200	90
Noninterest income.....	--	--	--	--	4,278	1,096
Noninterest expense.....	137	77	513	82	14,485	3,668
Net income (loss).....	(137)	(77)	(513)	(82)	2,313	489
Earnings (loss) per share.....	\$ (13.66)	\$ (7.71)	\$ (51.34)	\$ (8.17)	\$ 0.58	\$ 0.12
BALANCE SHEET:						
Cash and cash equivalents.....	\$ 113		\$ 396	\$ 170		\$ 30,406
Investment securities.....	--		--	--		48,969
Loans and leases, net.....	--		--	--		249,817
Other assets.....	616		205	27		22,780
Total assets.....	\$ 729		\$ 601	\$ 197		\$ 351,972
Deposits.....	\$ --		\$ --	\$ --		\$ 309,295
Accrued interest and other liabilities.....	174		94	139		5,369
Stockholders' equity.....	555		507	58		37,308
Total liabilities and stockholders' equity.....	\$ 729		\$ 601	\$ 197		\$ 351,972

</TABLE>

<TABLE>  
<CAPTION>

AT OR FOR THE THREE MONTHS ENDED MARCH 31,			AT OR FOR THE YEARS ENDED DECEMBER 31,		
1999	1998		1998	1997	1996

	(IN THOUSANDS)				
<S>	<C>	<C>	<C>	<C>	<C>
THE BANK OF HEMET					
RESULTS OF OPERATIONS:					
Interest income.....	\$ 4,719	\$ 4,887	\$ 19,416	\$ 18,991	\$ 19,127
Interest expense.....	2,135	2,316	9,185	8,946	8,823
Net interest income.....	2,584	2,571	10,231	10,045	10,304
Provision for loan losses.....	--	--	--	250	988
Noninterest income.....	384	305	1,363	1,204	1,248
Noninterest expense.....	1,801	1,709	6,736	6,200	8,182
Net income.....	\$ 686	\$ 679	\$ 2,823	\$ 2,802	\$ 1,373
BALANCE SHEET:					
Cash and cash equivalents.....	\$ 15,892		\$ 16,996	\$ 19,521	\$ 15,982
Investment securities.....	24,892		24,882	24,833	24,779
Loans and leases, net.....	207,273		205,570	190,171	185,200
Other assets.....	5,560		5,429	6,798	8,296
Total assets.....	\$ 253,617		\$ 252,877	\$ 241,323	\$ 234,257
Deposits.....	\$ 230,865		\$ 230,385	\$ 219,211	\$ 212,268
Accrued interest and other liabilities.....	1,548		1,468	1,884	1,887
Stockholders' equity.....	21,204		21,024	20,228	20,102
Total liabilities and stockholders' equity.....	\$ 253,617		\$ 252,877	\$ 241,323	\$ 234,257

</TABLE>

<TABLE>  
<CAPTION>

	AT OR FOR THE THREE		AT OR FOR THE YEARS ENDED DECEMBER		
	MONTHS ENDED MARCH 31,		31,		
	1999	1998	1998	1997	1996
<S>	(UNAUDITED)		(IN THOUSANDS)		
VALLEY BANK	<C>	<C>	<C>	<C>	<C>
RESULTS OF OPERATIONS:					
Interest income.....	\$ 1,422	\$ 1,559	\$ 6,181	\$ 5,978	\$ 5,338
Interest expense.....	366	342	1,438	1,282	1,119
Net interest income.....	1,056	1,217	4,743	4,696	4,219
Provision for loan losses.....	90	150	200	980	360
Noninterest income.....	712	459	2,915	2,719	2,135
Noninterest expense.....	1,452	1,553	6,085	5,637	5,211
Net income (loss).....	\$ 131	\$ (9)	\$ 789	\$ 556	\$ 454
BALANCE SHEET:					
Cash and cash equivalents.....	\$ 15,010		\$ 20,265	\$ 10,287	\$ 10,860
Investment securities.....	24,077		15,585	13,856	12,928
Loans and leases, net.....	41,734		42,031	44,202	42,634
Other assets.....	6,678		6,828	6,221	5,038
Total assets.....	\$ 87,499		\$ 84,709	\$ 74,566	\$ 71,360
Deposits.....	\$ 78,430		\$ 75,739	\$ 66,239	\$ 63,286
Accrued interest and other liabilities.....	630		716	1,035	1,172
Stockholders' equity.....	8,439		8,254	7,292	6,902
Total liabilities and stockholders' equity.....	\$ 87,499		\$ 84,709	\$ 74,566	\$ 71,360

</TABLE>

RISK FACTORS

IN ADDITION TO THE OTHER INFORMATION WE PROVIDE IN THIS PROSPECTUS, YOU SHOULD CAREFULLY CONSIDER THE FOLLOWING RISKS BEFORE DECIDING WHETHER TO INVEST IN OUR COMMON STOCK. THESE ARE NOT THE ONLY RISKS WE FACE. SOME RISKS ARE NOT YET KNOWN TO US AND THERE ARE OTHERS WE DO NOT CURRENTLY BELIEVE ARE MATERIAL BUT COULD LATER TURN OUT TO BE SO. ALL OF THESE COULD IMPAIR OUR BUSINESS, OPERATING RESULTS OR FINANCIAL CONDITION. THE TRADING PRICE OF OUR COMMON STOCK COULD DECLINE BECAUSE OF GENERAL MARKET CONDITIONS OR IF ANY OR ALL OF THESE

RISKS CAME TO PASS, AND YOU COULD LOSE ALL OR PART OF YOUR INVESTMENT. IN EVALUATING THE RISKS OF INVESTING IN US, YOU SHOULD ALSO EVALUATE THE OTHER INFORMATION SET FORTH IN THIS PROSPECTUS, INCLUDING OUR FINANCIAL STATEMENTS.

WE MAY NOT SUCCESSFULLY INTEGRATE AND MANAGE THE OPERATIONS OF THE BANK OF HEMET AND VALLEY BANK, AND THOSE OF OTHER BANKING OPERATIONS WE MAY ACQUIRE. IF we cannot do so, Pacific Community Banking Group will not succeed. Pacific Community Banking Group has no operating history. We formed in October 1997 to act as a bank holding company. We have acquired The Bank of Hemet and Valley Bank. Each of these banks has an operating history but not under our management. The banks hold substantially all of our assets and conduct substantially all of our business. If we cannot manage the banks successfully, it will reduce our operating results. We face the same kinds of risks in future acquisitions. The risks of acquisitions include the following:

- Management will have to divert time to integrate the new businesses;
- The acquired banks may have unexpected problems or risks in operations, personnel, technology or credit;
- We may lose the customers and employees of the acquired banks;
- New management may not work smoothly with our employees and customers;
- The assimilation of new operations, sites and personnel could divert resources from regular banking operations;
- When we make acquisitions, a portion of the purchase price, referred to as goodwill, may appear on our financial statements as an expense, which will reduce our reported income;
- New banks or branches may not generate enough revenue to offset acquisition costs;
- We may have trouble instituting and maintaining uniform standards, controls, procedures and policies.

WE MAY NOT REALIZE ANTICIPATED OPERATING EFFICIENCIES. Our business plan calls for us to increase profits by reducing costs, expanding services and integrating administrative functions. We may not realize these operating efficiencies, or we may not realize them as soon as we anticipate. If we do not realize operating efficiencies as anticipated, it could hurt our profitability.

WE MAY NOT ACHIEVE SUFFICIENT MARKET PRESENCE OR ECONOMIES OF SCALE IF WE DO NOT SUCCESSFULLY ACQUIRE ADDITIONAL BANKING ASSETS. Our business plan contemplates that we acquire additional community banks or branches of other community banks. However, we may not find appropriate community banking assets to acquire, or we may not find them on terms we believe appropriate. If we do not, we may not achieve a sufficient competitive presence in our markets or achieve desired economies of sale.

6

FUTURE SALES OF SECURITIES COULD DIMINISH THE INTERESTS OF OUR SHAREHOLDERS. If we raise additional funds or make acquisitions by issuing equity or convertible debt securities, the percentage ownership of our shareholders will be diluted. Also, any new securities could have rights, preferences and privileges senior to those of our common stock. We currently do not have any commitments for additional financing. We cannot be certain that additional financing will be available in the future to the extent required or that, if available, it will be made on acceptable terms.

IF WE LOSE KEY EMPLOYEES, OUR BUSINESS MAY SUFFER. If we lost key employees temporarily or permanently, it could hurt our business. We could be particularly hurt if our key employees went to work for competitors. Our future success depends on the continued contributions of our existing senior management personnel, particularly on the efforts of E. Lynn Caswell, the Chief Executive Officer and the Chairman of the Board of Pacific Community Banking Group. We will also depend on the continuing services of key management and staff members of The Bank of Hemet and Valley Bank, including Harold R. Williams, Jr. and Robert I. Robie. Mr. Caswell has an employment agreement with us, which includes provisions that limit his ability to compete against us at another company.

DETERIORATION OF ECONOMIC CONDITIONS IN SOUTHERN CALIFORNIA COULD ADVERSELY AFFECT OUR LOAN PORTFOLIO AND REDUCE THE DEMAND FOR OUR SERVICES. We focus our business in Southern California, primarily in Riverside county. In the early 1990's, the California economy experienced an economic recession that increased the level of delinquencies and losses for The Bank of Hemet, Valley Bank and many of the state's other financial institutions. Another recession could occur. An economic slow-down in Southern California could have the following consequences, any of which could reduce our net income:

- Loan delinquencies may increase;



- Problem assets and foreclosures may increase;
- Claims and lawsuits may increase;
- Demand for the banks' products and services may decline;
- Collateral for loans made by the banks, especially real estate, may decline in value, in turn reducing customers' borrowing power, reducing the value of assets associated with problem loans and reducing collateral coverage of the banks' existing loans.

A DOWNTURN IN THE REAL ESTATE MARKET COULD SERIOUSLY IMPAIR OUR LOAN PORTFOLIO. As of December 31, 1998, approximately 95 percent of the value of The Bank of Hemet's loan portfolio consisted of loans secured by various types of real estate. At that date, approximately 93 percent of the value of Valley Bank's loan portfolio consisted of loans secured by real estate, including government guaranteed loans with real estate collateral. Most of The Bank of Hemet's and Valley Bank's real property collateral is located in Southern California. If real estate values decline significantly, especially in California, higher vacancies and other factors could harm the financial condition of our borrowers, the collateral for our loans will provide less security, and we would be more likely to suffer losses on defaulted loans.

ENVIRONMENTAL LAWS COULD FORCE THE BANKS TO PAY FOR ENVIRONMENTAL PROBLEMS. The cost of cleaning up or paying damages and penalties associated with environmental problems could increase our operating expenses. When a borrower defaults on a loan secured by real property, the banks often purchase the property in foreclosure or accept a deed to the property

7

surrendered by the borrower. The banks may also take over the management of commercial properties whose owners have defaulted on loans. The banks also own and lease premises where their branches and other facilities are located. While the banks have lending, foreclosure and facilities guidelines intended to exclude properties with an unreasonable risk of contamination, hazardous substances may exist on some of the properties that the banks own, manage or occupy. The banks face the risk that environmental laws could force them to clean up the properties at their expense. It may cost much more to clean a property than the property is worth. The banks could also be liable for pollution generated by a borrower's operations if a bank took a role in managing those operations after a default. The banks may also find it difficult or impossible to sell contaminated properties.

WE ARE EXPOSED TO THE RISKS OF NATURAL DISASTERS. A major earthquake could result in material loss to the banks. Our operations are concentrated in Southern California, especially Riverside county. A significant percentage of our loans will be secured by real estate. California is an earthquake-prone region. The San Andreas Fault runs directly through our service area. Both of the banks have a disaster-recovery plan with offsite data processing resources located in Scottsdale, Arizona. However, the banks' properties and most of the real and personal property securing loans in the banks' portfolios are in Southern California. Many of our borrowers could suffer uninsured property damage, experience interruption of their businesses or lose their jobs after an earthquake. Those borrowers might not be able to repay their loans, and the collateral for loans could decline significantly in value. Unlike a bank with operations that are more geographically diversified, we are vulnerable to greater losses if an earthquake, fire, flood or other natural catastrophe occurs in Southern California.

LOAN LOSS RESERVES MAY NOT COVER ACTUAL LOAN LOSSES. If the actual loan losses exceed the amount reserved, it will hurt our business. The banks try to limit the risk that borrowers will fail to repay loans by carefully underwriting the loans. Losses nevertheless occur. The banks create reserves for estimated loan losses in their accounting records. They base these allowances on estimates of the following:

- industry standards;
- historical experience with our loans;
- evaluation of current and predicted economic conditions;
- regular reviews of the quality, mix and size of the overall loan portfolio;
- regular reviews of delinquencies; and
- the quality of the collateral underlying their loans.

AN INCREASE IN NONPERFORMING ASSETS WOULD REDUCE OUR INCOME AND INCREASE OUR EXPENSES. If the level of nonperforming assets rises in the future, it could adversely affect our operating results. Nonperforming assets are mainly loans on which the borrowers are not making their required payments. Nonperforming assets

also include loans that have been restructured to permit the borrower to have smaller payments and real estate that has been acquired through foreclosure of unpaid loans. To the extent that assets are non-performing, the banks have less cash available for lending and other activities.

8

CURTAILMENT OF GOVERNMENT GUARANTEED LOAN PROGRAMS COULD CUT OFF AN IMPORTANT SEGMENT OF OUR BUSINESS. If Valley Bank cannot continue making and selling government guaranteed loans, it will have less origination fees and less ability to generate gains on sale of loans. A major part of Valley Bank's business is the originating and selling of government guaranteed loans. From time to time, the government agencies that guarantee these loans reach their internal limits, and cease to guarantee loans for a stated time period. In addition, these agencies may change their rules for loans. Also, Congress may adopt legislation that would have the effect of discontinuing or changing the programs. Nongovernmental programs could replace government programs for some borrowers, but the terms might not be equally acceptable. Therefore, if these changes occur, the volume of loans to small business, industrial and agricultural borrowers of the types that now qualify for government guaranteed loans could decline. Also, the profitability of these loans could decline.

GOVERNMENTAL REGULATION MAY IMPAIR OUR OPERATIONS OR RESTRICT OUR GROWTH. If we fail to comply with the federal and state bank regulations, the regulators may limit our activities or growth, fine us or ultimately put us out of business. Banking laws and regulations change from time to time. Bank regulation can hinder our ability to compete with financial services companies that are not regulated or are less regulated. In addition, bank regulators impose material compliance costs on us.

Federal and state bank regulatory agencies regulate many aspects of our operations. These areas include:

- the capital we must maintain;
- the kinds of activities we can engage in;
- the kinds and amounts of investments we can make;
- the locations of our offices;
- how much interest we can pay on demand deposits;
- insurance of our deposits and the premiums we must pay for this insurance; and
- how much cash we must set aside as reserves for deposits.

IF VALLEY BANK FAILS TO MEET ITS COMMITMENTS TO BANK REGULATORS, IT COULD SUBJECT US TO REGULATORY ENFORCEMENT PROCEEDINGS. In October, 1998 the board of directors of Valley Bank adopted resolutions committing to accomplish the goals described below. The commitments include:

- to develop a formal written testing plan for Year 2000 issues;
- to maintain capital equal to 8% of Valley Bank's adjusted total assets;
- to improve asset quality;
- to improve earnings;
- to adopt procedures to ensure compliance with applicable law and regulations; and
- to obtain prior Federal Deposit Insurance Corporation approval for new directors and senior officers.

Valley Bank's management believes that Valley Bank is in compliance in these matters. In May 1999, Valley Bank developed and submitted a formal written Year 2000 compliance plan

9

to the Federal Deposit Insurance Corporation. Valley Bank may not continue to meet these commitments.

FAILURE TO ADDRESS YEAR 2000 PROBLEMS COULD IMPAIR OUR OWN OPERATIONS AND SUBJECT US TO LIABILITY FROM OUR CUSTOMERS AND OTHERS. If the banks, their vendors, customers or other third parties suffer a computer failure, it could require us to correct the consequences. After the acquisition transaction is completed, we will rely primarily on the data processing systems, hardware and software of The Bank of Hemet and Valley Bank to conduct our operations. Each of the banks has taken steps to make its own information and environmental systems Year 2000 compliant by the third quarter of 1999. Each bank has developed

contingency plans to reduce the impact of any failures which may occur. However, each also relies heavily on the information systems of vendors, customers and other third parties. These third parties may not become Year 2000 compliant soon enough. Moreover, the contingency and remediation efforts of the two banks may not succeed. For more information on the specific steps that the banks are taking, please refer to "The Bank of Hemet Management's Discussion and Analysis of Financial Condition and Results of Operations--Year 2000 Compliance" and "Valley Bank Management's Discussion and Analysis of Financial Condition and Results of Operations-- Year 2000 Compliance" below.

**FAILURE OF BANKLINK CORPORATION TO UPDATE ITS SYSTEMS COULD REDUCE ITS ABILITY TO COMPETE EFFECTIVELY.** BankLink Corporation is The Bank of Hemet's subsidiary that does data processing and item processing for several banks, including The Bank of Hemet. If its systems do not remain competitive, it may lose customers. However, the cost of upgrading systems to remain competitive may be a financial burden. The ability of BankLink Corporation to remain as the service provider for these banks depends on its continuing ability to offer competitive services.

**WE FACE POTENTIAL EXPOSURE TO LEGAL EXPENSES AND DAMAGES IN A LAWSUIT.** The Bank of Hemet is currently the defendant in a class action lawsuit. If this lawsuit is lost or settled, to the extent that insurance does not cover the cost, it will be an expense to us. After Pacific Community Banking Group acquires The Bank of Hemet, it will be at risk for the future results of this lawsuit. The lawsuit relates to The Bank of Hemet's 1992 acquisition of Inland Savings and Loan Association. The class action plaintiffs allege that the bank improperly adjusted the value of The Bank of Hemet preferred stock that was issued to the plaintiffs when The Bank of Hemet acquired Inland Savings and Loan Association. On January 14, 1999, the court certified the case as a class action. The complaint alleges breach of contract, and breach of fiduciary duty, and seeks compensatory damages in excess of \$2 million, together with punitive damages. The court has dismissed allegations of fraud that were the primary basis for punitive damages, although fiduciary claims could still be the basis for punitive damages. The Bank of Hemet is vigorously defending against these claims and has filed a motion for summary judgment on the breach of fiduciary duty claim. The Bank of Hemet believes that its insurance company will bear a substantial portion of the costs of any judgment relating to damages other than punitive damages. As a result, The Bank of Hemet has not established a reserve in its consolidated financial statements for a possible loss caused by this lawsuit.

**YOU MAY HAVE DIFFICULTY SELLING YOUR SHARES IN THE FUTURE IF AN ACTIVE TRADING MARKET FOR OUR STOCK DOES NOT DEVELOP.** Any reduction in the number of firms making a trading market in our stock may impair your ability to sell your shares of common stock. If that happens after

10

this offering, and if you then want to sell your Pacific Community Banking Group stock, you may encounter delay or have to accept a reduced price. We intend to list our stock on the Nasdaq National Market after this offering. Sutro & Co. Incorporated, Friedman, Billings, Ramsey & Co., Inc., Wedbush Morgan Securities, Inc. and Ragen MacKenzie Incorporated have indicated that they intend to act as market makers of our common stock as long as the volume of trading and other market-making considerations justify it. We cannot be sure how active the trading market for our common stock will be after the initial public offering.

**BECAUSE THE PRICE OF OUR COMMON STOCK MAY VARY WIDELY, WHEN YOU DECIDE TO SELL IT, YOU MAY ENCOUNTER DELAY OR HAVE TO ACCEPT A REDUCED PRICE.** The initial public offering price of Pacific Community Banking Group's common stock results from negotiations between us and the underwriters. Given the lack of any trading history of our common stock and our inability to predict where our common stock will trade in the future, we cannot be sure that the initial public offering price of our common stock will approximate the trading price of our common stock after this offering. The price of our common stock may fluctuate widely, depending on many factors. Some of these factors have little to do with our operating results or our intrinsic worth. For example, the market value of our common stock may be affected by the trading volume of the shares, announcements of expanded services by us or our competitors, general trends in the banking industry, general price and volume fluctuations in the stock market, acquisitions of related companies, variations in quarterly operating results, and the dilutive effects of future issuances of common or convertible preferred stock. Also, if the trading market for our common stock remains limited, that may exaggerate changes in market value, leading to more price volatility than would occur in a more active trading market.

**YOU WILL NOT RECEIVE DIVIDENDS.** We do not intend to pay dividends on Pacific Community Banking Group's common stock for the foreseeable future. Instead, we intend to reinvest our earnings in our business. In addition, to pay dividends to our shareholders, Pacific Community Banking Group would need to obtain funds from our bank subsidiaries. Their ability, in turn, to pay dividends to us is limited by California law and federal banking law. In particular, neither bank may pay a dividend that exceeds the lesser of either of the following:

- the bank's retained earnings; or
- the bank's net income for its last three fiscal years, minus the amount of any prior dividend during those three years.

With the approval of the regulators, a bank may pay dividends above those amounts, but not more than the greater of the bank's retained earnings, its net income for its last fiscal year, or its net income for the current fiscal year. Even if one of the banks were able to meet the dividend test described above, it might not be able to pay dividends if the result would cause its capital to fall below federal capital standards that apply to banks.

**SUBSTANTIAL SALES OF OUR COMMON STOCK COULD ADVERSELY AFFECT OUR STOCK PRICE.** Sales of substantial amounts of Pacific Community Banking Group's common stock in the public market after the completion of the initial public offering could hurt the market price of our common stock. Some shares of our common stock are subject to a contractual lock-up agreement. Under this agreement, some shareholders will be restricted from selling their shares for either 90 or 180 days. Former shareholders of The Bank of Hemet and Valley Bank who were directors of those banks and non-director holders of Pacific Community Banking Group before the acquisition will be restricted for 90 days. Directors of Pacific Community Banking

11

Group before the acquisition will be restricted for 180 days. Still, sales of substantial amounts of common stock after this offering could cause the price of Pacific Community Banking Group's common stock to decline. That could reduce our ability to raise capital by issuing additional common stock.

At the completion of the initial public offering and the bank acquisitions, various shares of common stock will be subject to possible sale and issue by Pacific Community Banking Group. The sale of those shares could dilute the already issued common stock. For example, after the closing of this offering and the bank acquisitions:

- In connection with the acquisitions of both The Bank of Hemet and Valley Bank, the shareholders of those banks will receive warrants to purchase our common stock, and shares of our common stock will be issued whenever those warrants are exercised.
- Mr. Caswell's employment agreement provides that at the close of the acquisitions and public offering, he will be granted options to purchase up to 250,000 shares or 5% of our common stock, whichever is greater. These options will be issued under an option plan that has received shareholder approval.
- We intend to grant stock options to employees, consultants and directors of Pacific Community Banking Group, The Bank of Hemet and Valley Bank. These options, too, will be issued under an option plan that has received approval of the shareholders of Pacific Community Banking Group. Additional shares of common stock will be issued when these people exercise their options.
- We intend to pursue acquisitions of other financial institutions from time to time in exchange for the issuance of additional shares of our common stock or other securities convertible into or exercisable for our common stock.
- We will be authorized under our articles of incorporation to issue additional shares of common stock, and preferred stock that may be convertible into common stock, without further shareholder approval.

**BANK REGULATORY LAWS COULD DISCOURAGE CHANGES IN OUR OWNERSHIP.** These regulations would delay and possibly discourage a potential acquirer who would have been willing to pay a premium price to amass a large block of our common stock. That in turn could decrease the value of our common stock and the price that you will receive if you sell your shares in the future. Before anyone can buy enough voting stock to exercise control over a bank holding company like us, bank regulators must approve the acquisition. A shareholder must apply for regulatory approval to own 10 percent or more of our common stock, unless the shareholder can show that he or she will not actually exert control over us. In no case can a shareholder own more than 25 percent of our stock without applying for regulatory approval.

**PROVISIONS IN OUR CHARTER DOCUMENTS AND AGREEMENTS WE HAVE MADE WILL DELAY OR PREVENT CHANGES IN CONTROL OF OUR CORPORATION OR OUR MANAGEMENT.** These provisions make it more difficult for another company to acquire us, which could reduce the market price of our common stock and the price that you will receive if you sell your shares in the future. These provisions include the following:

- A provision requiring a two-thirds vote when shareholders approve business combinations, approve amendments to the charter and bylaws and take action by written consent;

- A requirement that shareholders give advance notice of nominations for election of members of the board of directors at a meeting of shareholders; and
- Staggered terms of office for members of the board of directors.

Contractual arrangements that impede changes in control include severance agreements for our executive officers and commitments to issue options.

#### FORWARD-LOOKING STATEMENTS

Some of the statements under "Prospectus Summary," "Risk Factors," "Management's Discussion and Analysis of Financial Condition and Results of Operations," "Business" and elsewhere in this Prospectus constitute forward-looking statements. These statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance, or achievements expressed or implied by the forward-looking statements. These factors include, among other things, those listed under "Risk Factors" and elsewhere in this prospectus.

In some cases, you can identify forward-looking statements by terminology such as "may," "will," "should," "could," "expects," "plans," "intends," "anticipates," "believes," "estimates," "predicts," "potential," or "continue" or the negative of such terms and other comparable terminology.

Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements.

#### USE OF PROCEEDS

We estimate that our net proceeds from the sale of shares by us in this offering, after deducting underwriting discounts and commissions and estimated offering expenses payable by us, Pacific Community Banking Group, will be \$ million (\$ million if the underwriters exercise their over-allotment option in-full). We intend to use the net proceeds for working capital and general corporate purposes, and to pay a portion of the expenses of our acquisitions of The Bank of Hemet and Valley Bank and the offering, including the fee of Sutro & Co. Incorporated as compensation for its advisory services. Until they are needed, the net proceeds will be invested in short-term, investment grade, interest-bearing obligations.

We will not receive any proceeds from the sale of shares by the selling shareholders. Please refer to "Principal and Selling Shareholders" on page 111.

#### DIVIDEND POLICY

Pacific Community Banking Group has never declared or paid dividends on its common stock and anticipates that all earnings will be retained for use in its business. The payment of any future dividends will be at the discretion of the board of directors. Please refer to "Management's Discussion and Analysis of Financial Condition and Results of Operations."

#### CAPITALIZATION

THROUGHOUT THIS PROSPECTUS, WHEN CALCULATING NUMBERS OF SHARES AND NUMBERS "PER SHARE" WE HAVE ASSUMED THAT THE UNDERWRITERS WILL NOT EXERCISE THEIR OVER-ALLOTMENT OPTION, EXCEPT WHERE WE STATE THAT WE INCLUDED THE OVER-ALLOTMENT OPTION IN THE CALCULATIONS.

The following table sets forth (i) the capitalization of Pacific Community Banking Group as of March 31, 1999, after giving effect to the business combination of Pacific Community Banking Group, The Bank of Hemet and Valley Bank, and (ii) the capitalization of Pacific Community Banking Group as adjusted to give effect to the sale of shares of common stock and automatic conversion of 1,460,000 shares of preferred stock into shares of common stock offered by Pacific Community Banking Group at an assumed initial public offering price of \$ per share and the application of the net proceeds after deducting the underwriting discount and estimated offering expenses. Please refer to "Use of Proceeds" for additional information about the planned use of proceeds of this offering. This table should be read in conjunction with the "Unaudited Summary Pro Forma Combined Financial Information" and the Consolidated Financial Statements included in this prospectus.

<TABLE>  
<CAPTION>

MARCH 31, 1999

<S>

<C>	<C>
PRO FORMA AS COMBINED	PRO FORMA AS ADJUSTED (2)

<CAPTION>

(DOLLARS IN THOUSANDS)  
(UNAUDITED)

<S>

	<C>	<C>
Preferred stock; no par value, 100,000,000 shares authorized:		
Series A: 1,085,000 shares authorized and outstanding, pro forma as combined and none, pro forma as adjusted, net of unpaid subscriptions.....	\$ 924	\$ --
Series B: 375,000 shares authorized, and outstanding, pro forma as combined and none, pro forma as adjusted, net of unpaid subscriptions.....	360	--
Common stock, no par value: 100,000,000 shares authorized; 3,970,765 shares outstanding, pro forma as combined and 4,442,195, pro forma as adjusted(1,2).....	21,171	
Retained earnings.....	14,853	14,853
Total stockholders' equity.....	37,308	
Total capitalization.....	\$ 37,308	\$

</TABLE>

(1) Excludes 1,308,000 warrants for the purchase of common stock issued in connection with the business combination with Valley Bank and The Bank of Hemet.

(2) Includes \$ to give effect to the net proceeds from the sale of approximately shares of common stock offered through this prospectus as well as conversion of all shares of Series A and Series B preferred stock into common stock effective at the close of the offering.

14

DILUTION

As of March 31, 1999, Pacific Community Banking Group had a pro forma net tangible book value of approximately \$26,786,000, or \$6.75 per share of common stock, after giving effect to the business combination of The Bank of Hemet, Valley Bank and Pacific Community Banking Group. Pro forma net tangible book value per share represents total tangible assets less total liabilities, divided by the number of shares of common stock outstanding at that date. Without taking into account any other changes in the pro forma net tangible book value after March 31, 1999 other than to give effect to the receipt by Pacific Community Banking Group of the net proceeds to Pacific Community Banking Group from the sale of approximately shares of common stock offered at the initial public offering price of \$ per share, the pro forma net tangible book value at March 31, 1999 would have been approximately \$ or \$6.52 per share. This represents an immediate decrease in net tangible book value of \$.23 per share to existing shareholders and an immediate dilution of \$8.48 per share to new investors purchasing shares of common stock in this offering. The following table illustrates this per share dilution:

<TABLE>

<S>	<C>	<C>
Initial public offering price per share.....		\$
Pro forma net tangible book value per share.....	\$ 6.75	
Decrease per share attributable to new investors.....	(.23)	
Pro forma net tangible book value per share after this offering.....		6.52
Dilution per share to new investors.....		\$

</TABLE>

The following table summarizes, on a pro forma basis, as of March 31, 1999, the differences between the number of shares of common stock purchased from Pacific Community Banking Group, the aggregate assumed consideration from existing shareholders and price per share from new investors purchasing shares of common stock in this offering. Sales by the selling shareholders in this offering will reduce the number of shares of common stock held by existing shareholders to a total of 942,000, or approximately 21% (approximately 19% if the underwriters' over-allotment option is exercised in full) of the total number of shares of common stock outstanding after this offering. Please refer to "Principal and Selling Shareholders" on page 111.

<TABLE>  
<CAPTION>

	SHARES PURCHASED		TOTAL ASSUMED CONSIDERATION		AVERAGE PRICE PER SHARE
	NUMBER	PERCENT	AMOUNT	PERCENT	
<S>	<C>	<C>	<C>	<C>	<C>
Existing shareholders, pro forma as combined(1).....	3,970,765	89.4%	\$ 26,785,840	79.1%	\$ 6.75
New investors.....		10.6%		20.9%	
Total.....		100.0%	\$	100.0%	

</TABLE>

(1) Includes holders of preferred stock that will automatically convert to common stock upon completion of this offering. This information assumes no exercise of the Underwriter's over-allotment option and no exercise of stock options or warrants that will be outstanding after this offering.

15

#### REGULATORY CAPITAL AND LEVERAGE RATIO

The following table illustrates the actual regulatory capital and leverage ratios of The Bank of Hemet and Valley Bank and the pro forma regulatory capital and leverage ratios of Pacific Community Banking Group, in each case, as of December 31, 1998. The pro forma ratios are stated after giving effect to this offering and the acquisitions, assuming approximately \$ million in net proceeds is raised in this offering; all of which is held in cash or cash equivalent investments. Please refer to "Unaudited Pro Forma Combined Financial Data" and the assumptions set forth therein.

<TABLE>  
<CAPTION>

	AT DECEMBER 31, 1998		
	LEVERAGE RATIO	TIER 1 RISK-BASED CAPITAL RATIO	TOTAL RISK-BASED CAPITAL RATIO
<S>	<C>	<C>	<C>
The Bank of Hemet.....	8.31%	9.99%	11.06%
Valley Bank.....	10.20	15.50	16.70
Minimum regulatory requirement for a "well-capitalized" bank(1).....	5.00	6.00	10.00
Minimum regulatory capital for a bank(1).....	4.00	4.00	8.00
Pro forma for Pacific Community Banking Group after the offering and acquisitions.....	7.55	9.56	10.81
Minimum regulatory requirement for a well-capitalized holding company(2).....	5.00	6.00	10.00
Minimum regulatory capital for a holding company(2).....	4.00	4.00	8.00

</TABLE>

(1) Pursuant to regulations of the Federal Deposit Insurance Corporation. Please refer to "Supervision and Regulation--Capital Standards."

(2) Pursuant to regulations of the Federal Reserve Board. Please refer to "Supervision and Regulation--Capital Standards."

THE ACQUISITIONS

Immediately before this offering, Pacific Community Banking Group acquired The Bank of Hemet for approximately 2,977,888 shares of Pacific Community Banking Group common stock plus warrants exercisable into approximately 876,000 shares of Pacific Community Banking Group common stock at an exercise price of \$ per share.

Immediately before this offering, Pacific Community Banking Group also acquired Valley Bank for approximately 863,049 shares of Pacific Community Banking Group common stock, and warrants exercisable into approximately 432,000 shares of Pacific Community Banking Group common stock at an exercise price of \$ per share.

Pacific Community Banking Group expects to consolidate the operations of Valley Bank with those of The Bank of Hemet and commence separate banking operations in Orange county.

16

This offering is made for two purposes:

- New shares are being sold by Pacific Community Banking Group to raise capital for ongoing operations and to pay certain fees incurred in connection with the acquisitions and expenses of the offering; and
- former shareholders of The Bank of Hemet and Valley Bank are selling some of the shares they will receive in the acquisitions.

Pacific Community Banking Group has used this structure for its acquisitions of The Bank of Hemet and Valley Bank because it believes that the structure strengthens the transaction in its financial characteristics and potential market performance.

Sutro & Co. Incorporated has advised Pacific Community Banking Group in connection with identifying The Bank of Hemet and Valley Bank and negotiating the acquisitions. As compensation for these services, Sutro & Co. Incorporated will receive a fee of \$750,000 on the closing of the acquisitions.

UNAUDITED PRO FORMA COMBINED FINANCIAL INFORMATION

The following unaudited pro forma combined statements of operations for the year ended December 31, 1998 and the three months ended March 31, 1999 reflects the business combination of The Bank of Hemet, Valley Bank, and Pacific Community Banking Group as if it had occurred on January 1, 1998. The following unaudited pro forma combined balance sheet reflects the business combination as if it had occurred as of March 31, 1999. Under generally accepted accounting principles, the business combination is treated as an acquisition of Pacific Community Banking Group and Valley Bank by The Bank of Hemet using the purchase method of accounting. The pro forma financial information gives effect to the business combination consistent with such principles.

The pro forma financial information should be read in conjunction with the accompanying notes thereto and with the financial statements of the respective companies. The pro forma combined financial information does not purport to be indicative of operating results which would have been achieved had the acquisitions occurred on the dates indicated and should not be construed as representative of future operating results. In the opinion of Pacific Community Banking Group's management, all adjustments have been made to reflect the effects of the acquisitions.

17

PRO FORMA COMBINED STATEMENT OF OPERATIONS  
(UNAUDITED)  
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

<TABLE>  
<CAPTION>

	HISTORICAL--YEAR ENDED DECEMBER 31, 1998				PRO FORMA COMBINED-- YEAR ENDED DECEMBER 31, 1998
	PACIFIC COMMUNITY BANKING GROUP	THE BANK OF HEMET	VALLEY BANK	PRO FORMA ADJUSTMENTS	
<S>	<C>	<C>	<C>	<C>	<C>
Interest income.....	\$ --	\$ 19,416	\$ 6,181	\$ --	\$ 25,597
Interest expense.....	--	9,185	1,438	--	10,623



Net interest income.....		10,231	4,743		14,974
Provision for loan losses.....	--	--	200	--	200
Net interest income after provision.....	--	10,231	4,543	--	14,774
Noninterest income.....	--	1,363	2,915	--	4,278
Noninterest expense					
Salaries and employee benefits.....	--	3,735	3,272	267 (1)	7,274
Premises and equipment.....	--	1,066	921	--	1,987
Other real estate owned, net.....	--	(101)	41	--	(60)
Other expenses.....	513	2,036	1,851	884 (2)	5,284
Total noninterest expense.....	513	6,736	6,085	1,151	14,485
Income before income taxes.....	(513)	4,858	1,373	(1,151)	4,567
Provision for income taxes.....	--	2,035	584	(365) (3)	2,254
Net income (loss).....	\$ (513)	\$ 2,823	\$ 789	\$ (786)	\$ 2,313
Pro forma net income per share.....					\$ 0.58 (4)
Pro forma shares outstanding.....					3,970,765 (4)

</TABLE>

- (1) Reflects a provision for \$36,000 for compensation due to former officers of The Bank of Hemet, which vests in full as of the closing of the business combination, and reflects payments totaling \$231,000 due under noncompete and consulting agreements with the former officers.
- (2) Reflects amortization of goodwill and other intangible assets resulting from the acquisitions as if they had been completed as of the first day of the period presented. Goodwill is amortized using a 25-year life, and other intangible assets, which consist primarily of a core deposits intangible, are amortized based on the expected runoff of the related deposits. The estimated runoff of such deposits will result in amortization of the balance of the core deposits intangible asset on an accelerated basis over a period of ten years.
- (3) Reflects the income tax effect of the pro forma adjustments at an effective rate of 40% for the amortization of the core deposits intangible and the additional compensation due to the former officers of the Bank of Hemet.
- (4) Pro forma net income per share is calculated on a fully diluted basis. Pro forma weighted average shares outstanding is calculated giving effect to the conversion of The Bank of Hemet common stock to Pacific Community Banking Group common stock at a conversion ratio of 3.4 to one, the shares of Pacific Community Banking Group common stock issuable pursuant to the acquisition of Valley Bank, and the conversion of all shares of Pacific Community Banking Group preferred stock into shares of common stock.

18

PRO FORMA COMBINED STATEMENT OF OPERATIONS  
(UNAUDITED)  
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

<TABLE>  
<CAPTION>

	HISTORICAL--THREE MONTHS ENDED MARCH 31, 1999				PRO FORMA COMBINED-- THREE MONTHS ENDED MARCH 31, 1999
	PACIFIC COMMUNITY BANKING GROUP	THE BANK OF HEMET	VALLEY BANK	PRO FORMA ADJUSTMENTS	
<S>	<C>	<C>	<C>	<C>	<C>
Interest income.....	\$ --	\$ 4,719	\$ 1,422	\$ --	\$ 6,141
Interest expense.....	--	2,135	366	--	2,501
Net interest income.....		2,584	1,056		3,640
Provision for loan losses.....	--	--	90	--	90
Net interest income after provision.....	--	2,584	966	--	3,550
Noninterest income.....	--	384	712	--	1,096
Noninterest expense					
Salaries and employee benefits.....	47	1,037	831	58 (1)	1,973

Premises and equipment.....	10	247	218	--	475
Other real estate owned, net.....	--	(3)	26	--	23
Other expenses.....	80	520	377	220 (2)	1,197
Total noninterest expense.....	137	1,801	1,452	278	3,668
Income before income taxes.....	(137)	1,167	226	(278)	978
Provision for income taxes.....	--	481	95	(87) (3)	489
Net income (loss).....	\$ (137)	\$ 686	\$ 131	\$ (191)	\$ 489
Pro forma net income per share.....					\$ 0.12 (4)
Pro forma shares outstanding.....					3,970,765 (4)

</TABLE>

- (1) Reflects payments due to former officers of The Bank of Hemet under noncompete and consulting agreements.
- (2) Reflects amortization of goodwill and other intangible assets resulting from the acquisitions as if they had been completed as of the first day of the period presented. Goodwill is amortized using a 25-year life, and other intangible assets, which consist primarily of a core deposits intangible, are amortized based on the expected runoff of the related deposits. The estimated runoff of such deposits will result in amortization of the balance of the core deposits intangible asset on an accelerated basis over a period of ten years.
- (3) Reflects the income tax effect of the pro forma adjustments at an effective rate of 40% for the amortization of the core deposits intangible and the additional compensation due to the former officers of the Bank of Hemet.
- (4) Pro forma net income per share is calculated on a fully diluted basis. Pro forma weighted average shares outstanding is calculated giving effect to the conversion of The Bank of Hemet common stock to Pacific Community Banking Group common stock at a conversion ratio of 3.4 to one, the shares of Pacific Community Banking Group common stock issuable pursuant to the acquisition of Valley Bank, and the conversion of all shares of Pacific Community Banking Group preferred stock into shares of common stock.

19

PRO FORMA COMBINED BALANCE SHEET  
(UNAUDITED)  
(IN THOUSANDS)

<TABLE>  
<CAPTION>

	HISTORICAL--MARCH 31, 1999				
	PACIFIC COMMUNITY BANKING GROUP	THE BANK OF HEMET	VALLEY BANK	PRO FORMA ADJUSTMENTS	PRO FORMA COMBINED
<S>	<C>	<C>	<C>	<C>	<C>
Cash and due from banks.....	\$ 113	\$ 5,892	\$ 6,111	\$ (609) (1)	\$ 11,507
Federal funds sold.....	--	10,000	8,899	--	18,899
Total cash and cash equivalents.....	113	15,892	15,010	(609)	30,406
Investment securities.....	--	24,892	24,077	--	48,969
Loans and leases.....	--	209,503	42,849	810 (2)	253,162
Allowance for loan losses.....	--	(2,230)	(1,115)	--	(3,345)
Loans and leases, net.....	--	207,273	41,734	810	249,817
Premises and equipment, net.....	5	1,613	2,126	--	3,744
Accrued interest receivable.....	--	1,285	555	--	1,840
Other real estate owned.....	--	83	1,611	--	1,694
Other assets.....	611	2,579	2,386	(596) (3)	4,980
Goodwill and other intangible assets.....	--	--	--	10,522 (4)	10,522
Total assets.....	\$ 729	\$ 253,617	\$ 87,499	\$ 10,127	\$ 351,972

Deposits						
Noninterest bearing demand deposits.....	\$	--	\$ 33,664	\$ 20,319	\$ --	\$ 53,983
Savings and interest-bearing demand deposits.....		--	71,485	40,895	--	112,380
Time deposits.....		--	125,716	17,216	--	142,932
Accrued interest and liabilities.....		174	1,548	630	3,017	3,5 5,369
Stockholders' equity						
Common stock.....		3	3,666	5,624	11,878 (6)	21,171
Preferred stock.....		1,284	--	--	--	1,284
Retained earnings.....		(732)	17,538	2,815	(4,768) (6)	14,853
		-----	-----	-----	-----	-----
Total stockholders' equity.....		555	21,204	8,439	7,110	37,308
		-----	-----	-----	-----	-----
Total liabilities and equity.....	\$	729	\$ 253,617	\$ 87,499	\$ 10,127	\$ 351,972
		-----	-----	-----	-----	-----

</TABLE>

- 
- (1) Reflects a special dividend of \$0.52 per common share of Valley Bank, payable at the closing of the acquisition.
  - (2) To adjust the carrying value of loans and leases at Valley Bank to their estimated fair value.
  - (3) To record a deferred tax liability of approximately \$2,160,000 related to the value attributable to a core deposits intangible asset, which was recorded in accrued interest and other liabilities net of a deferred tax asset of \$730,000, as well as deferred taxes of \$334,000 relating to the severance obligations discussed below. Also includes reclassification of \$200,000 of capitalized acquisition costs to goodwill and other intangible assets.

20

- (4) To record the purchase of Valley Bank and Pacific Community Banking Group, which results in the allocation of the excess of the purchase price over their net identifiable assets of \$8,705,000 and \$1,817,000, respectively, to goodwill and other intangible assets. The goodwill will be amortized over 25 years. Other intangible assets consist primarily of core deposit intangibles, which will be amortized based on the expected runoff of the related deposits. The estimated runoff of such deposits will result in amortization of the balance of the core deposit intangibles on an accelerated basis over a period of ten years.
- (5) To record a liability of \$94,000 to former officers of The Bank of Hemet, which was formerly payable beginning at the respective officer's retirement date, but which vests in full as of the closing of the business combination, and to record severance costs at Valley Bank of \$743,000. Additionally, includes an accrual for acquisition fees of \$750,000 payable upon completion of the acquisitions.
- (6) To provide for adjustments related to the application of purchase accounting, which includes the recognition of value for the warrants issued to Valley Bank and to eliminate the equity accounts of the subsidiaries. The estimated fair value of the warrants to be issued to shareholders of both The Bank of Hemet and Valley Bank is \$3 per warrant. Additionally, to adjust equity accounts for the warrants issued to shareholders of The Bank of Hemet, the value for which is charged to retained earnings, with a corresponding increase to common equity.

21

PACIFIC COMMUNITY BANKING GROUP SELECTED FINANCIAL DATA

The following table sets forth selected financial data of Pacific Community Banking Group. The following financial data should be read in conjunction with "Management's Discussion and Analysis of Financial Condition" and Pacific Community Banking Group's financial statements appearing in this prospectus.

<TABLE>  
<CAPTION>

AT OR FOR THE THREE		AT OR FOR YEAR	AT OR FOR PERIOD
MONTHS ENDED MARCH 31,		ENDED	FROM INCEPTION
1999	1998	DECEMBER 31, 1998	(OCTOBER 1997) TO
			DECEMBER 31, 1997
-----	-----	-----	-----

(UNAUDITED)

<S>	<C>	<C>	<C>	<C>
<b>OPERATIONS:</b>				
Revenues.....	\$ --	\$ --	\$ --	\$ --
General and administrative expenses.....	140,222	77,141	525,568	82,477
Interest income.....	3,568	--	11,326	--
	-----	-----	-----	-----
Net loss before taxes.....	136,654	77,141	514,242	82,477
Provision for income taxes.....	--	--	800	800
	-----	-----	-----	-----
Net loss.....	\$ 136,654	\$ 77,141	\$ 513,442	\$ 81,677
	-----	-----	-----	-----
<b>PER SHARE DATA:</b>				
Basic and diluted earnings (loss) per share.....	\$ (13.66)	\$ (7.71)	\$ (51.34)	\$ (8.17)
Weighted average shares outstanding.....	10,000	10,000	10,000	10,000
<b>ASSETS:</b>				
Cash.....	\$ 113,294		\$ 395,948	\$ 170,131
Prepaid expenses.....	--		1,333	--
Capitalized acquisition and offering costs.....	610,218		198,127	26,814
Equipment and furniture, net of depreciation.....	5,152		5,638	--
	-----		-----	-----
	-----		-----	-----
Total Assets.....	\$ 728,664		\$ 601,046	\$ 196,945
	-----		-----	-----
	-----		-----	-----
<b>LIABILITIES AND SHAREHOLDERS' EQUITY:</b>				
Accounts payable.....	\$ 174,097		\$ 94,429	\$ 54,112
Refundable common stock subscriptions.....	--		--	85,000
Total shareholders' equity.....	554,567		506,617	57,833
	-----		-----	-----
	-----		-----	-----
Total liabilities and shareholders' equity.....	\$ 728,664		\$ 601,046	\$ 196,945
	-----		-----	-----
	-----		-----	-----

</TABLE>

PACIFIC COMMUNITY BANKING GROUP  
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION  
AND RESULTS OF OPERATIONS

THE FOLLOWING MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS CONTAINS FORWARD-LOOKING STATEMENTS THAT INVOLVE RISKS AND UNCERTAINTIES. PACIFIC COMMUNITY BANKING GROUP'S ACTUAL RESULTS COULD DIFFER MATERIALLY FROM THOSE ANTICIPATED IN THESE FORWARD-LOOKING STATEMENTS AS A RESULT OF THE FACTORS DESCRIBED IN THE SECTION ENTITLED "RISK FACTORS" AND ELSEWHERE IN THIS PROSPECTUS.

RESULTS OF OPERATIONS

Pacific Community Banking Group was formed in 1997 for the purpose of becoming a multi-bank, community oriented, independent bank holding company that will own a number of community banks, predominantly in high-growth areas of Southern California. Since inception, Pacific Community Banking Group has investigated a number of banks for possible acquisition. These discussions have resulted in the acquisition of The Bank of Hemet and Valley Bank. Until these proposed acquisitions were completed immediately before this offering, Pacific Community Banking Group had no revenue-generating operations. Since its founding, Pacific Community Banking Group's only income has been interest earned on investments and deposits. Nearly all of its expenses have been used for organizational purposes in connection with proposed acquisition opportunities and the initial public offering of its stock.

CAPITAL CONTRIBUTIONS

The holders of Pacific Community Banking Group's common stock have provided approximately \$2,500, and the holders of Pacific Community Banking Group's convertible preferred stock have provided capital of approximately \$1.3 million as of March 31, 1999, in each case to fund the costs associated with identifying and acquiring selected community banks and raising the funds for the initial acquisitions and operations. For more information about the holders of this preferred stock and their interests in Pacific Community Banking Group after the acquisitions, please refer to the section entitled "Principal and Selling Shareholders" on page 111.

LIQUIDITY AND CAPITAL RESOURCES

Based on its current operating plan, Pacific Community Banking Group believes that it has sufficient liquidity to meet its cash obligations for the next 12 months. It believes that the net proceeds of the public offering of its common stock, together with its available funds, are sufficient to provide working capital and fund capital expenditures in the near future. Pacific Community Banking Group currently plans to acquire other banks. If the

shareholders of the banks it seeks to acquire will not accept Pacific Community Banking Group stock in exchange for their shares, Pacific Community Banking Group will need to raise additional capital to make these acquisitions for cash. If so, Pacific Community Banking Group may seek to raise capital through sales of its securities to private investors or to the public. These sales may not be feasible at times because of market conditions. There is no guarantee that Pacific Community Banking Group will acquire other banks.

23

#### YEAR 2000 COMPLIANCE

Since the formation of Pacific Community Banking Group, information technology has not played an important role in its operations. These operations have consisted of investigating and negotiating potential bank acquisitions. Pacific Community Banking Group has acquired all of its computer hardware and software since October, 1997 and believes its systems are Year 2000 compliant. This hardware and software consists only of personal computers used for word processing and spreadsheet calculations. If, notwithstanding the assurances received from vendors regarding the fact that these computers are Year 2000 compliant, they prove to be noncompliant, as a contingency, Pacific Community Banking Group could obtain word processing and spreadsheet capabilities from third party services. After the acquisitions, Pacific Community Banking Group will not perform data processing services for its banking subsidiaries. Rather, The Bank of Hemet will continue to conduct data processing operations through its subsidiary, BankLink Corporation. Valley Bank will become a customer of BankLink Corporation for data processing and item processing by June 27, 1999. For information on Year 2000 compliance issues for the banks, including their contingency plans, please refer to the sections entitled "The Bank of Hemet Management's Discussion and Analysis of Financial Condition--Year 2000 Compliance," beginning on page 43, and "Valley Bank Management's Discussion and Analysis of Financial Condition--Year 2000 Compliance," beginning on page 78.

#### BUSINESS OF PACIFIC COMMUNITY BANKING GROUP

##### GENERAL

A private group of investors led by E. Lynn Caswell, an experienced California community banker, formed our company in 1997. Our company was formed to become a multi-bank, community oriented, independent bank holding company, which intends to acquire a select number of community banks, predominantly in high-growth areas of Southern California. We intend to find strategically located community banks, each of which has a successful history and a favorable image in its market area. Where appropriate we will consolidate the operations of acquired banks, but generally each bank will retain its separate market identity. We plan to achieve economies of management and scale by combining some administrative and support functions, such as financial administration, data processing, insurance, bonding, employee benefits and contracts for services.

Since inception, we have investigated a number of banks for possible acquisition, and have initiated discussions with several banks. These discussions have resulted in the acquisition of The Bank of Hemet and Valley Bank, which are described elsewhere in this prospectus. We intend to continue discussing potential acquisitions with other banks where those discussions are appropriate. No such acquisitions are currently pending.

##### BUSINESS STRATEGY

We base our business philosophy on the belief that banking customers value doing business with locally managed institutions that can provide a full service commercial banking relationship through an understanding of the customer's financial needs and the flexibility to customize products and services to meet those needs. We also believe that banks can better build successful customer relationships by affiliating with a holding company that provides cost effective administrative support services while promoting bank autonomy and flexibility.

24

To implement this philosophy, we intend to operate some of our acquired banks as separate subsidiaries and retain their independent names along with their individual boards of directors. We expect that many of our acquired banks, such as The Bank of Hemet and Valley Bank, will have established strong reputations and customer followings in their respective market areas through attention to client service and an understanding of client needs. Where market overlap makes a consolidation of operations among existing banks more cost-efficient, as is the case with Valley Bank and The Bank of Hemet, we intend to consolidate their operations. In addition, where we perceive that a community lacks a strong independent community bank and would be an appropriate market for one, we intend to form a new bank to fill that community need. We intend, within the next two years, to develop a community bank in Orange county, based on our perception that Orange county is one such community.

We intend to keep client service decisions and day-to-day operations at the bank level. But we also plan to offer the advantages of affiliation with a

multi-bank holding company by providing improved access to the capital markets and expanded client support services, such as financial administration, management and accounting services and possibly internet-based asset and liability generation. In addition, our centralized administration, including support in credit policy formulation and review, investment management, data processing, employee benefits, accounting, insurance and other specialized support functions will allow the banks to focus on client service.

Our goal is to become the preeminent financial services company for independent banks in high growth areas of Southern California, commencing with Riverside and San Bernardino counties. Our business strategy is to increase our market share within the communities we serve through internal growth after we acquire The Bank of Hemet and Valley Bank. We will also pursue opportunities to expand our market share through select acquisitions and development of banks that complement our existing businesses.

#### THE INLAND EMPIRE

Riverside and San Bernardino counties are commonly referred to as the "Inland Empire." This region is experiencing dramatic population and economic growth. The Inland Empire will include the fastest growing U.S. primary metropolitan statistical area during the years 1993 to 2005, according to a 1996 report of the U.S. Department of Commerce. The Department of Commerce projected that population in the area will grow 32.4% during that period.

#### EMPLOYEES

At December 31, 1998, we had two employees, one of whom was an executive officer. Neither is represented by a union or covered by a collective bargaining agreement. We believe our employee relations are excellent.

#### PREMISES

We lease approximately 1,050 square feet of space in an executive office suite in Laguna Hills, California. The lease will expire in April 2000. Lease payments include various office support services, and average approximately \$3,000 per month. These premises are not large enough for our future needs. We expect to move into larger premises.

25

#### SUPERVISION AND REGULATION

As a bank holding company, we are subject to many governmental rules that affect our operations. For a description of the laws and regulations that will apply to Pacific Community Banking Group, please refer to the section entitled "Supervision and Regulation," starting on page 114.

#### LITIGATION

We have not become involved in any litigation, and know of no threatened litigation against us that would be material to our operations.

26

#### THE BANK OF HEMET SELECTED FINANCIAL DATA

The following tables present selected historical consolidated financial data, including per share information, for The Bank of Hemet. The following financial data should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the consolidated financial statements of The Bank of Hemet included or incorporated by reference in this prospectus.

<TABLE>  
<CAPTION>

	AT OR FOR THE THREE MONTHS ENDED MARCH 31,		AT OR FOR THE YEAR ENDED DECEMBER 31,				
	1999	1998	1998	1997	1996	1995	1994
	(DOLLARS IN THOUSANDS EXCEPT PER SHARE INFORMATION)						
	(UNAUDITED)						
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
RESULTS OF OPERATIONS							
Interest income.....	\$ 4,719	\$ 4,887	\$ 19,416	\$ 18,991	\$ 19,127	\$ 19,386	\$ 16,601
Interest expense.....	2,135	2,316	9,185	8,946	8,823	9,102	6,615
Net interest income.....	2,584	2,571	10,231	10,045	10,304	10,284	9,986
Provision for loan and lease losses.....	--	--	--	250	988	120	1,500
Noninterest income.....	384	305	1,363	1,204	1,248	1,218	1,933
Noninterest expense.....	1,801	1,709	6,736	6,200	8,182	7,368	9,197
Net income.....	686	679	2,823	2,802	1,373	2,321	609
BALANCE SHEET (END OF PERIOD)							

Total assets.....	\$ 253,617	\$ 244,510	\$ 252,877	\$ 241,323	\$ 234,257	\$ 227,955	\$ 223,772
Total loans.....	209,503	196,174	207,802	192,287	187,441	185,717	185,746
Allowance for loan and lease losses.....	2,230	2,059	2,232	2,116	2,241	2,135	2,609
Nonperforming loans(1).....	2,220	3,016	1,581	2,902	2,993	2,460	3,188
Other real estate owned.....	83	558	77	779	2,180	3,908	2,719
Total deposits.....	230,865	222,516	230,385	219,211	212,268	207,425	203,583
Stockholders' equity.....	21,204	20,400	21,024	20,228	20,102	19,078	17,670
BALANCE SHEET (PERIOD AVERAGE)							
Total assets.....	\$ 255,185	\$ 244,018	\$ 248,297	\$ 236,297	\$ 231,532	\$ 227,438	\$ 221,431
Total loans.....	207,631	192,938	196,675	187,298	184,307	183,632	185,708
Earning assets.....	246,163	234,301	238,910	226,311	219,822	216,052	207,672
Total deposits.....	232,808	222,258	226,228	214,291	209,938	207,323	200,000
Shareholders' equity.....	21,121	20,285	20,594	20,146	20,130	18,695	18,335
CAPITAL RATIOS							
Leverage ratio.....	8.31%	8.36%	8.31%	8.53%	8.66%	8.21%	7.98%
Tier 1 risk-based capital.....	10.01	10.33	9.99	10.43	10.77	10.29	9.81
Total risk-based capital.....	11.06	11.37	11.06	11.53	11.97	11.44	11.07
ASSET QUALITY RATIOS							
Nonperforming loans/total loans(1).....	1.06%	1.54%	0.76%	1.51%	1.60%	1.32%	1.72%
Nonperforming assets/total assets(2).....	0.91	1.46	0.66	1.53	2.21	2.79	2.64
Allowance for loan losses/nonperforming loans.....	100.44	68.27	141.16	72.90	74.86	86.78	81.84
Allowance for loan losses/total loans.....	1.06	1.05	1.07	1.10	1.20	1.15	1.40
PERFORMANCE RATIOS							
Return on average assets.....	1.08%	1.11%	1.14%	1.19%	0.59%	1.02%	0.27%
Return on average equity.....	13.00	13.40	13.71	13.91	6.82	12.42	3.32
Net interest margin(3).....	4.20	4.39	4.28	4.44	4.69	4.76	4.81
Net interest spread(4).....	3.40	3.54	3.37	3.55	3.90	4.05	4.29
Average total loans to average deposits.....	89.19	86.81	86.94	87.40	87.79	88.57	92.85
Efficiency ratio(5).....	60.68	59.42	58.10	55.11	70.83	64.06	77.16
PER SHARE INFORMATION							
Basic earnings(6).....	\$ .81	\$ .80	\$ 3.34	\$ 3.25	\$ 1.53	\$ 2.73	\$ 0.74
Diluted earnings(7).....	\$ .79	\$ .78	\$ 3.23	\$ 3.15	\$ 1.53	\$ 2.70	\$ 0.70
Common stock dividends declared.....	\$ .60	\$ .60	\$ 2.40	\$ 1.50	\$ 1.00	\$ 1.00	\$ 0.25
Dividend payout ratio(8).....	73.8%	74.6%	71.8%	46.2%	65.4%	36.6%	33.7%
Common stock book value.....	\$ 25.12	\$ 24.16	\$ 24.90	\$ 23.96	\$ 22.46	\$ 23.03	\$ 21.86
Common shares outstanding at period end(9).....	844,252	844,252	844,252	844,252	894,901	828,398	807,594
Weighted average common shares outstanding(10).....	844,252	844,252	844,252	863,252	881,705	813,661	806,244

</TABLE>

(1) Nonperforming loans consist of loans on nonaccrual and loans past due 90 days or more.

(2) Nonperforming assets consist of nonperforming loans and other real estate owned.

27

(3) Net interest margin is net interest income expressed as a percentage of average total interest-earning assets.

(4) Net interest spread is the difference between the yield on average total interest-earning assets and cost of average total interest-bearing liabilities.

(5) The efficiency ratio is the ratio of noninterest expense to the sum of net interest income before provision for loan losses and total noninterest income.

(6) Basic earnings per share is computed by dividing net income by the weighted average number of shares outstanding during the period.

(7) Diluted earnings per share reflects the potential dilution that would occur if securities or other contracts to issue common stock were exercised or converted into the common stock or resulted in the issuance of common stock that then shared in earnings.

(8) The dividend payout ratio consists of the common stock dividends paid per share of common stock divided by basic earnings per share of common stock.

(9) Based on shares outstanding at period end, excluding shares issuable upon exercise of outstanding options.

(10) Weighted average number of shares of common stock outstanding for the period, excluding shares issuable upon exercise of outstanding options.

28

THE FOLLOWING MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS CONTAINS FORWARD-LOOKING STATEMENTS THAT INVOLVE RISKS AND UNCERTAINTIES. THE BANK OF HEMET'S ACTUAL RESULTS COULD DIFFER MATERIALLY FROM THOSE ANTICIPATED IN THESE FORWARD-LOOKING STATEMENTS AS A RESULT OF FACTORS SET FORTH IN THE SECTION ENTITLED "RISK FACTORS" AND ELSEWHERE IN THIS PROSPECTUS.

The following discussion and analysis is designed to provide a better understanding of the significant changes and trends related to The Bank of Hemet and its subsidiaries' financial condition, operating results, asset and liability management, liquidity and capital resources. Averages presented in the tables are daily average balances. The following discussion should be read in conjunction with the consolidated financial statements of The Bank of Hemet.

#### FINANCIAL CONDITION AS OF MARCH 31, 1999 COMPARED TO DECEMBER 31, 1998

At March 31, 1999, the bank's total assets were \$253.6 million, compared to \$252.9 million at year end 1998. The slight increase in total assets primarily results from an increase in net loans of \$1.7 million, partially offset by a reduction in cash and cash equivalents of \$1.1 million.

The bank's primary asset category continues to be its loan portfolio, which comprised 81.36% of average total assets during the first three months of 1999. Real estate secured loans totaling \$199.3 million continue to comprise the largest component of the portfolio, with approximately \$168.2 million in loans secured by commercial properties, \$28.2 million in loans secured by residential properties, and \$2.9 million in construction and land development loans as of March 31, 1999. The ratio of delinquent loans to total loans decreased from 1.16% at December 31, 1998 to 1.13% at March 31, 1999.

The allowance for loan and lease losses was \$2.2 million at March 31, 1999, essentially unchanged from December 31, 1998. The ratio of the allowance for loan and lease losses as a percentage of total loans was 1.06% as of March 31, 1999 compared to 1.07% as of December 31, 1998. Net charge-offs during the three months ended March 31, 1999 totaled \$2,000.

The ratio of the allowance for loan and lease losses as a percentage of nonperforming loans decreased from 141.18% at December 31, 1998 to 99.38% at March 31, 1999. The decrease in this ratio primarily resulted from a temporary increase in nonperforming loans at March 31, 1999. During the first quarter of 1999, a performing loan secured by commercial property became past due when the bank did not extend the loan's maturity date. Although the bank placed the loan on nonaccrual status during the first quarter of 1999, the loan was paid in full in April 1999. The allowance for loan and lease losses allocated to this loan was unchanged during the quarter due to the adequacy of collateral and the pending payoff of the matured loan.

At March 31, 1999, nonperforming assets were \$2.3 million, or 1.10% of total loans and foreclosed real estate, compared to \$1.7 million or 0.80%, respectively, at December 31, 1998.

Nonperforming loans of \$2.2 million at March 31, 1999 included \$344,000 secured by single family residential properties, \$1.9 million secured by commercial properties, and zero in

29

commercial and installment loans. Nonperforming loans of \$1.6 million at December 31, 1998 included \$113,000 secured by single family residential properties, \$1.5 million secured by commercial properties, and zero in commercial and installment loans. The increase in nonperforming loans primarily resulted from a loan secured by commercial property becoming past due during the first quarter of 1999 when the bank did not extend the loan's maturity date. The loan was paid in full in April 1999.

Total OREO assets increased from \$77,000 at December 31, 1998 to \$83,000 at March 31, 1999. During the first three months of 1999, OREO assets increased by \$83,000 due to the acquisition of one property and decreased by \$77,000 as the result of one property being sold.

Investment securities remained relatively unchanged during the first quarter of 1999. Investment securities with a book value of \$13.0 million at March 31, 1999 and \$10.0 million at December 31, 1998 were pledged to secure public funds deposited and for other purposes as required or permitted by law.

Other assets of \$2.6 million at March 31, 1999 were principally composed of a deferred tax asset in the amount of \$786,000, compared to a deferred tax asset of \$906,000 at December 31, 1998.

Total deposits at March 31, 1999 were \$230.9 million, an increase of \$480,000 from December 31, 1998. The mix of deposits for March 31, 1999 compared to December 31, 1998 represents an increase in time certificates of deposit of



\$695,000, an increase in savings and interest bearing demand deposits of \$242,000, partially offset by a decrease in noninterest bearing demand deposits of \$311,000.

Accrued interest payable and other liabilities remained relatively unchanged during the first quarter of 1999.

Stockholders' equity at March 31, 1999 was \$21.2 million, compared to \$21.0 million at year end 1998, an increase of \$180,000, or 0.86%. Equity was increased by net income of \$686,000, offset by the payment of cash dividends in the amount of \$506,000. In April 1999, the Board of Directors declared a cash dividend of \$0.60 per share of common stock. The Bank of Hemet paid the dividend on May 18, 1999 to shareholders of record as of May 10, 1999.

#### RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED MARCH 31, 1999 AND 1998

OVERVIEW. The bank reported net income of \$686,000 for the three months ended March 31, 1999, compared to \$679,000 for the same period in 1998. Basic earnings per share equaled \$0.81 for the three months ended March 31, 1999, compared to \$0.80 for the same period in 1998.

NET INTEREST INCOME. Net interest income for the three months ended March 31, 1999 was \$2.6 million, an increase of \$13,000 or 0.51%, over the same period in 1998. The increase in net interest income primarily resulted from an increase in the volume of average interest earning assets (principally loan volume) of \$11.9 million, partially offset by an increase in the average volume of interest bearing liabilities (principally time deposits) of \$6.7 million. The net interest spread, which represents the average yield earned on interest earning assets less the average yield paid on interest bearing liabilities, decreased to 3.40% for the three months

30

ended March 31, 1999 from 3.54% for the same period in 1998. Average interest earning assets comprised 96.46% of total average assets for the three months ended March 31, 1999, compared to 96.02% for the same period in 1998. Average interest bearing deposits as a percentage of total deposits declined from 85.99% for the three months ended March 31, 1998 to 84.97% for the same period in 1999, as the result of continued improvement in the mix of deposits.

PROVISION FOR LOAN AND LEASE LOSSES. The provision for loan and lease losses was \$0 for both the quarters ended March 31, 1999 and March 31, 1998, respectively. Net charge-offs for the three months ended March 31, 1999 were \$2,000, compared to \$57,000 for the same period in 1998.

NONINTEREST INCOME. Noninterest income for the three months ended March 31, 1999 increased to \$384,000, compared to \$305,000 for the same period in 1998. Revenues from data processing fees generated by the bank's wholly-owned subsidiary, BankLink Corporation, increased to \$227,000 for the three months ended March 31, 1999 from \$143,000 for the same period in 1998.

NONINTEREST EXPENSE. Noninterest expense for the three months ended March 31, 1999 was \$1.8 million compared to \$1.7 million for the same period in 1998, an increase of \$92,000 or 5.38%. Salaries and employee benefits increased by \$104,000 for the three months ended March 31, 1999 when compared to the same period in 1998. In March 1999, the bank employed 88 full-time equivalent employees compared to 74 full-time equivalent employees in March 1998.

Other noninterest expense, which includes services for data and item processing, Federal Deposit Insurance Corporation and other insurance expense, professional fees and other miscellaneous expense, increased by \$21,000 for the three months ended March 31, 1999, when compared to the same period in 1998. Fees paid to third parties for analyzed business deposit accounts decreased by \$17,000 for the three months ended March 31, 1999 when compared to the same period in 1998, partially offset by increased legal fees of \$28,000 during the same period.

#### FINANCIAL CONDITION AS OF DECEMBER 31, 1998 AND 1997

Total assets at December 31, 1998 equaled \$252.9 million, an increase of \$11.6 million, or 4.8%, over total assets of \$241.3 million at December 31, 1997. Total loans equaled \$207.8 million at December 31, 1998, an increase of \$15.5 million, or 8.1%, over total loans of \$192.3 million at December 31, 1997. This increase was partially offset by a decrease in cash and cash equivalents, accrued interest receivable and other real estate owned ("OREO"). The loan to deposit ratio grew to 90.2% at year-end 1998, from 87.7% at year-end 1997. The ratio of average total loans to average deposits, however, remained in a relatively narrow range, equaling 86.9% in 1998, compared with 87.4% in 1997 and 87.8% in 1996.

The Bank of Hemet continued to decrease its nonperforming loans. At December 31, 1998, nonperforming loans equaled \$1.6 million, or 0.77% of total loans. This represented a reduction of \$1.3 million, or 44.8%, from nonperforming loans of \$2.9 million, comprising 1.51% of total loans, at December 31, 1997. In turn,

the year-end 1997 level of nonperforming loans represented a reduction of \$91,000, or 3.04%, from nonperforming loans of \$3.0 million, comprising 1.60% of total loans at December 31, 1996.

31

The allowance for loan and lease losses equaled \$2.2 million at December 31, 1998, compared with an allowance of \$2.1 million at December 31, 1997. The allowance at December 31, 1998 represented 1.07% of total loans, compared with 1.10% of total loans at December 31, 1997 and 1.20% at December 31, 1996. Net recoveries during 1998 were \$116,000 compared to net charge-offs of \$375,000 in 1997 and \$882,000 in 1996. In addition, the allowance for loan and lease losses represented 141.2% of nonperforming loans at December 31, 1998, compared with 72.9% at December 31, 1997 and 74.9% at December 31, 1996.

The Bank of Hemet also showed significant improvement in reducing levels of OREO in 1998. OREO decreased by \$702,000, or 90.1%, to \$77,000, the lowest level of OREO in five years. OREO equaled \$779,000 at December 31, 1997 and \$2.2 million at December 31, 1996.

These foregoing developments resulted in an improvement of the ratio of earning assets to total average assets over the last three years. For 1998, the ratio equaled 96.2%, compared with 95.8% for 1997 and 94.9% for 1996.

Deposits were \$230.4 million at December 31, 1998, an increase of \$11.2 million, or 5.1%, over deposits of \$219.2 million at December 31, 1997. The increase was primarily as a result of increases in noninterest bearing demand deposits of 15.9% and savings and interest bearing demand deposits of 13.4%. Average interest bearing deposits represented 85.3% of average total deposits for 1998 compared with 86.1% in 1997.

Total shareholders' equity was \$21.0 million at December 31, 1998, an increase of \$796,000, or 3.9%, from \$20.2 million at December 31, 1997.

RESULTS OF OPERATIONS FOR THE YEARS ENDED DECEMBER 31, 1998, 1997 AND 1996

OVERVIEW. The Bank of Hemet reported net income for 1998 of \$2.8 million compared with \$2.8 million in 1997 and \$1.4 million in 1996. The return on average assets was 1.14% in 1998 compared with 1.19% in 1997 and 0.59% in 1996. The Bank of Hemet's return on average equity was 13.71% for 1998, 13.91% for 1997 and 6.82% for 1996.

Basic earnings per share equaled \$3.34 in 1998 compared with \$3.25 in 1997 and \$1.53 in 1996. Diluted earnings per share equaled \$3.23 in 1998 compared with \$3.15 in 1997 and \$1.53 in 1996. Cash dividends were declared at \$2.40 per share for 1998, \$1.50 per share for 1997 and \$1.00 per share for 1996. This resulted in dividend payout ratios, computed as common stock dividends declared per share divided by basic earnings per share of 71.8% in 1998, 46.2% in 1997 and 65.4% in 1996.

NET INTEREST INCOME. Net interest income is the primary source of operating income of the bank. Net interest income represents the difference between the interest income from earning assets and the interest paid on interest-bearing liabilities. Net interest income for 1998 increased \$186,000, or 1.9%, to \$10.2 million when compared with 1997. The increase in 1998 was primarily attributable to an increase in loan volume, partially offset by reduced loan yields and a lower net interest spread. The net interest spread, which represents the average yield earned on interest earning assets less the average yield paid on interest bearing liabilities, decreased to 3.37% in 1998 from 3.55% in 1997.

Net interest income for 1997 decreased \$259,000 to \$10.0 million, or 2.5%, when compared with net interest income of \$10.3 million for 1996. The decrease in 1997 was primarily attributable to reduced loan yields and a lower net interest spread, partially offset by

32

increased loan volume. The net interest spread decreased to 3.55% in 1997 from 3.90% in 1996.

AVERAGE BALANCES AND RATES EARNED AND PAID. The following table presents, for the periods indicated, consolidated average balance sheet information for The Bank of Hemet, together with interest rates earned and paid on the various sources and uses of its funds. The table is arranged to group the elements of earning assets and interest-bearing liabilities, as these items represent the major sources of income and expense.

<TABLE>  
<CAPTION>

<S>	YEAR ENDED DECEMBER 31,						
	<C>	<C>	<C>	<C>	<C>	<C>	
	1998			1997			1996

<CAPTION>	AVERAGE BALANCE	INTEREST INCOME/ EXPENSE	RATES EARNED/ PAID	AVERAGE BALANCE	INTEREST INCOME/ EXPENSE	RATES EARNED/ PAID	AVERAGE BALANCE	INTEREST INCOME/ EXPENSE
	(DOLLARS IN THOUSANDS)							
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
<b>ASSETS</b>								
Federal funds sold.....	\$ 13,183	\$ 704	5.34%	\$ 10,432	\$ 563	5.40%	\$ 9,675	\$ 509
Investment securities(1).....	29,052	1,610	5.54	28,581	1,633	5.71	25,840	1,416
Total loans(2)(3).....	196,675	17,102	8.70	187,298	16,795	8.97	184,307	17,202
	-----	-----	-----	-----	-----	-----	-----	-----
Total earning assets.....	\$ 238,910	\$ 19,416	8.13%	\$ 226,311	\$ 18,991	8.39%	\$ 219,822	\$ 19,127
Allowance for loan and lease losses.....	(2,111)			(2,116)			(2,108)	
Cash and due from banks.....	5,742			5,405			5,301	
Premises and equipment.....	1,614			1,531			1,618	
Interest receivable and other assets.....	4,142			5,166			6,899	
	-----			-----			-----	
Total assets.....	\$ 248,297			\$ 236,297			\$ 231,532	
	-----			-----			-----	
	-----			-----			-----	
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>								
Interest bearing demand deposits.....	\$ 14,204	\$ 152	1.07%	\$ 13,722	\$ 151	1.10%	\$ 14,837	\$ 168
Money market deposits.....	3,970	108	2.72	4,660	128	2.75	5,393	152
Savings deposits.....	48,793	1,955	4.01	47,468	1,949	4.11	41,968	1,709
Time deposits of \$100,000 or more.....	9,036	501	5.54	8,662	489	5.65	15,537	891
Time deposits under \$100,000...	116,876	6,469	5.53	109,948	6,214	5.65	106,222	5,903
Other borrowings.....	--	--	--	249	15	6.02	--	--
	-----	-----	-----	-----	-----	-----	-----	-----
Total interest bearing liabilities.....	\$ 192,879	\$ 9,185	4.76%	\$ 184,709	\$ 8,946	4.84%	\$ 183,957	\$ 8,823
Noninterest bearing demand deposits.....	33,349			29,831			25,981	
Other liabilities.....	1,475			1,611			1,464	
Shareholders' equity.....	20,594			20,146			20,130	
	-----			-----			-----	
Total liabilities and shareholders' equity.....	\$ 248,297			\$ 236,297			\$ 231,532	
	-----			-----			-----	
	-----			-----			-----	
Net interest income.....		\$ 10,231			\$ 10,045			\$ 10,304
		-----			-----			-----
		-----			-----			-----
Net interest spread(4).....			3.37%			3.55%		
Net interest margin(5).....			4.28%			4.44%		

<CAPTION>	
<S>	<C>
	RATES EARNED/ PAID
	-----
<b>ASSETS</b>	
Federal funds sold.....	5.26%
Investment securities(1).....	5.48
Total loans(2)(3).....	9.33
Total earning assets.....	8.70%
Allowance for loan and lease losses.....	
Cash and due from banks.....	
Premises and equipment.....	
Interest receivable and other assets.....	
Total assets.....	
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>	
Interest bearing demand deposits.....	1.13%
Money market deposits.....	2.82
Savings deposits.....	4.07
Time deposits of \$100,000 or more.....	

more.....	5.73
Time deposits under \$100,000...	5.56
Other borrowings.....	--
Total interest bearing	
liabilities.....	4.80%
Noninterest bearing demand	
deposits.....	
Other liabilities.....	
Shareholders' equity.....	
Total liabilities and	
shareholders' equity.....	
Net interest income.....	
Net interest spread(4).....	3.90%
Net interest margin(5).....	4.69%

- (1) There are no tax exempt investment securities in the investment securities portfolio for any of the reported years.
- (2) Average balances are presented net of deferred loan origination fees. Nonaccruing loans of \$2.4 million for 1998, \$3.2 million for 1997 and \$2.9 million for 1996 are included in the table for computational purposes.
- (3) Loan origination fees are included in interest income as adjustments of the loan yields over the life of the loan using the interest method. Loan interest income includes loan fees of \$532,000 for 1998, \$457,000 for 1997 and \$642,000 for 1996.
- (4) Net interest spread represents the average yield earned on interest-earning assets less the average rate paid on interest-bearing liabilities.
- (5) Net interest margin is computed by dividing net interest income by total average earning assets.

NET INTEREST INCOME CHANGES DUE TO VOLUME AND RATE. The following table sets forth, for the periods indicated, a summary of the changes in average asset and liability balances and interest earned and paid resulting from changes in average asset and liability balances, referred to as "volume," and changes in average interest rates. The changes in interest due to both rate and volume are designated as "Mix."

	1998 COMPARED WITH 1997				1997 COMPARED WITH 1996	
	INCREASE (DECREASE) DUE TO CHANGE IN:				INCREASE (DECREASE) DUE TO CHANGE IN:	
	AVERAGE VOLUME	AVERAGE RATE	MIX	TOTAL	AVERAGE VOLUME	
(DOLLARS IN THOUSANDS)						
INCREASE (DECREASE) IN INTEREST INCOME						
Federal funds sold.....	\$ 149	\$ (6)	\$ (2)	\$ 141	\$ 40	
Investment securities(1).....	27	(49)	(1)	(23)	151	
Loans(2) (3).....	841	(509)	(25)	307	279	
<b>Total.....</b>	<b>\$ 1,017</b>	<b>\$ (564)</b>	<b>\$ (28)</b>	<b>\$ 425</b>	<b>\$ 470</b>	
INCREASE (DECREASE) IN INTEREST EXPENSE						
Interest bearing demand deposits.....	\$ 5	\$ (4)	\$ --	\$ 1	\$ (12)	
Money market deposits.....	(19)	(1)	--	(20)	(21)	
Savings deposits.....	54	(47)	(1)	6	224	
Time deposits of \$100,000 or more.....	21	(9)	(0)	12	(394)	
Time deposits under \$100,000.....	391	(128)	(8)	255	207	
Other borrowings.....	(15)	(15)	15	(15)	--	
<b>Total.....</b>	<b>437</b>	<b>(204)</b>	<b>6</b>	<b>239</b>	<b>4</b>	

TOTAL CHANGE IN NET INTEREST INCOME.....	\$ 580	\$ (360)	\$ (34)	\$ 186	\$ 466
	-----	-----	---	-----	-----

<CAPTION>

<S>	<C>	<C>	<C>
	AVERAGE RATE	MIX	TOTAL
	-----	---	-----
<S>	<C>	<C>	<C>
INCREASE (DECREASE) IN INTEREST INCOME			
Federal funds sold.....	\$ 13	\$ 1	\$ 54
Investment securities(1).....	60	6	217
Loans(2) (3).....	(675)	(11)	(407)
	-----	---	-----
Total.....	\$ (602)	\$ (4)	\$ (136)
	-----	---	-----
INCREASE (DECREASE) IN INTEREST EXPENSE			
Interest bearing demand deposits.....	\$ (5)	\$ --	\$ (17)
Money market deposits.....	(4)	1	(24)
Savings deposits.....	14	2	240
Time deposits of \$100,000 or more.....	(14)	6	(402)
Time deposits under \$100,000.....	100	4	311
Other borrowings.....	--	15	15
	-----	---	-----
Total.....	91	28	123
	-----	---	-----
TOTAL CHANGE IN NET INTEREST INCOME.....	\$ (693)	\$ (32)	\$ (259)
	-----	---	-----

</TABLE>

- 
- (1) There are no tax exempt investment securities in the investment securities portfolio for any of the reported years.
  - (2) Average balances are presented net of deferred loan origination fees. Nonaccruing loans of \$2.4 million for 1998, \$3.2 million for 1997 and \$2.9 million for 1996 are included in the table for computational purposes.
  - (3) Loan origination fees are included in interest income as adjustments of the loan yields over the life of the loan using the interest method. Loan income includes loan fees of \$532,000 for 1998, \$457,000 for 1997 and \$642,000 for 1996.

PROVISION FOR LOAN AND LEASE LOSSES. The provision for loan and lease losses charged to operations reflects management's judgment of the adequacy of the allowance for loan and lease losses. The provision is determined through periodic analysis, which includes a detailed review of the classification and categorization of problem loans; an assessment of the overall quality and collectability of the portfolio; and consideration of the loan loss experience, trends

34

in problem loans and concentrations of credit risk, evaluation of collateral, as well as current and expected economic conditions, particularly in segments of The Bank of Hemet's market area. Such reviews also assist management in establishing the recommended level of the allowance for loan and lease losses. The Bank of Hemet's board of directors approves the adequacy of the allowance for loan and lease losses on a quarterly basis.

For 1998, The Bank of Hemet recorded no provision for loan and lease losses, compared with provisions of \$250,000 for 1997 and \$988,000 for 1996. In 1998 net recoveries totaled \$116,000, compared with net charge-offs of \$375,000 in 1997 and \$882,000 in 1996. The lack of a provision in 1998 and the substantial decrease in the provision in 1997 over 1996 reflected management's view of the improved asset quality of The Bank of Hemet's loan portfolio, which benefited from strengthening of the Southern California economy.

NONINTEREST INCOME. Noninterest income for 1998 increased \$159,000, or 13.2%, to \$1.4 million, compared with \$1.2 million for 1997. The increase in 1998 was principally attributable to increased data processing fees generated by BankLink Corporation, partially offset by a reduction in fees earned for the servicing of real estate secured loans for third parties, and a reduction in fees and service charges on deposits.

Noninterest income in 1997 remained at the same level, \$1.2 million, as in 1996. The lack of change was attributable to a decrease in revenue from processing of merchant credit card drafts and a reduction in fees earned for the

servicing of real estate secured loans for third parties, offset by increased data processing fees generated by BankLink Corporation.

NONINTEREST EXPENSE. Noninterest expense for 1998 was \$6.7 million, compared with \$6.2 million for 1997 and \$8.2 million for 1996. The principal components of the increase in 1998 were:

- Salaries and employee benefits. Salaries and employee benefits increased in 1998 by \$273,000, or 7.9%, as The Bank of Hemet increased the number of full time equivalent employees to 86 at December 31, 1998 from 77 at December 31, 1997.
- OREO expenses. OREO expenses for 1998 resulted in a net credit of \$101,000. The primary components of the credit were net gains on the sale of OREO properties of \$173,000, partially offset by OREO holding costs of \$61,000 and OREO writedowns of \$11,000. However, the 1998 net credit was below that of \$187,000 for 1997, contributing to the increase in such noninterest expenses. The net credit for 1997 benefited, in particular, from the reversal of an OREO loss reserve of \$182,000 and net gains on the sale of OREO of \$128,000, offset by OREO holding costs of \$123,000.
- Premises and equipment expenses. Premises and equipment expense increased \$79,000, or 8.0%, in 1998 over 1997, primarily as a result of increased equipment depreciation and maintenance expense.
- Other expenses. Other expenses increased in 1998 by \$98,000, or 5.1%. This category of expense includes services for data and item processing, Federal Deposit Insurance Corporation and other insurance expense, professional fees and other miscellaneous expense. The increase in 1998 is mainly the result of increased fees paid to third parties for analyzed business deposit accounts and increased professional fees.

35

In 1997, noninterest expense decreased by 24.2% over its 1996 level. The principal component of the decrease was OREO expenses. This expense category decreased by \$1.4 million in 1997 as a result of a decrease in writedowns of \$1.2 million, decreased carrying costs of \$179,000 and an increase in gains on sale of OREO of \$91,000. Other expenses also decreased in 1997 compared with 1996. The decrease in other expenses for 1997 of \$359,000 is mainly the result of a special one-time assessment of \$402,000 in 1996 on deposits acquired from a savings and loan association in 1992. The special assessment was part of a deposit insurance recapitalization plan enacted by Congress, and applied to all institutions holding deposits derived from savings institutions. Other expenses related to the processing of merchant credit card drafts also decreased. These decreases were partially offset by an increase in 1997 of professional fees related to litigation. Salaries and employee benefits also decreased in 1997 by \$178,000, or 4.9% as a result of an operational restructuring commencing the second quarter of 1996, designed to streamline branch operations and support staff. Premises and equipment expense also decreased slightly in 1997 over 1996, primarily by reason of reduced depreciation expense related to BankLink Corporation's mainframe computer.

The Bank of Hemet's efficiency ratio--which is the ratio of noninterest expense to the sum of net interest income before provision for loan losses and total noninterest income--was 58.1% in 1998, compared with 55.1% in 1997 and 70.8% in 1996. The improvement in the ratio in 1997 and 1998, over 1996 reflects primarily the significant reduction in OREO expenses from the levels experienced in 1996.

PROVISION FOR INCOME TAXES. The Bank of Hemet's provision for income taxes was \$2.0 million in 1998, \$2.0 million in 1997 and \$1.0 million in 1996. These changes corresponded directly to changes in pre-tax income. The effective income tax rate was 41.9% in 1998 compared with 41.6% in 1997 and 42.4% in 1996.

NET INCOME. Net income in 1998 remained at the 1997 level of \$2.8 million. In 1998, The Bank of Hemet experienced increases in net interest income of \$186,000, primarily from increased loan volume. Noninterest income increased by \$159,000, primarily from The Bank of Hemet's data processing subsidiary. In addition, the provision for loan and lease losses decreased by \$250,000 as no provision was taken in 1998. However, these favorable developments were almost entirely offset by increased noninterest expenses of \$536,000, primarily relating to increases in salaries and employee benefits.

In 1997, net income increased \$1.4 million, or 104.1%, to \$2.8 million from the 1996 level of \$1.4 million. This increase was attributable to two major components. First, noninterest expense decreased by approximately \$2.0 million, or 24.2%, principally as a result of reductions in expenses associated with the disposition of OREO, as explained above. Second, the provision for loan losses decreased by \$738,000, or 74.7%. These increases were partially offset by decreases in net interest income and noninterest income.

SUMMARY SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)

The following table presents a summary of selected quarterly financial data, which should be read in conjunction with The Bank of Hemet's consolidated financial statements and notes thereto included elsewhere in this prospectus. In the opinion of management, this information has been prepared on the same basis as the consolidated financial statements appearing elsewhere in this prospectus, and includes all adjustments, consisting only of normal recurring adjustments, necessary to present fairly the unaudited results set forth herein. The operating

results for any quarter are not necessarily indicative of results for any subsequent period or for the entire year.

<TABLE>

<CAPTION>

<S>	FOR THE QUARTER ENDED						
	<C>	<C>	<C>	<C>	<C>	<C>	<C>
	MARCH 1999	DECEMBER 1998	SEPTEMBER 1998	JUNE 1998	MARCH 1998	DECEMBER 1997	SEPTEMBER 1997

<CAPTION>

<S>	(DOLLARS IN THOUSANDS, EXCEPT PER SHARE DATA)						
	<C>	<C>	<C>	<C>	<C>	<C>	<C>
Net interest income.....	\$ 2,584	\$ 2,491	\$ 2,596	\$ 2,573	\$ 2,571	\$ 2,530	\$ 2,475
Provision for loan and lease losses.....	--	(125)	--	125	--	190	60
Net income.....	686	789	694	661	679	741	645
Basic earnings per share(1).....	\$ 0.81	\$ 0.94	\$ 0.82	\$ 0.78	\$ 0.80	\$ 0.88	\$ 0.76
Diluted earnings per share(2).....	\$ 0.79	\$ 0.91	\$ 0.79	\$ 0.75	\$ 0.78	\$ 0.85	\$ 0.74

<CAPTION>

<S>	<C>	<C>
	JUNE 1997	MARCH 1997

Net interest income.....	\$ 2,582	\$ 2,458
Provision for loan and lease losses.....	--	--
Net income.....	743	673
Basic earnings per share(1).....	\$ 0.85	\$ 0.75
Diluted earnings per share(2).....	\$ 0.84	\$ 0.74

</TABLE>

(1) Basic earnings per share is computed by dividing net income by the weighted average number of shares outstanding during the period.

(2) Diluted earnings per share reflects the potential dilution that would occur if securities or other contracts to issue common stock were exercised or converted into the common stock or resulted in the issuance of common stock that then shared in earnings.

ASSET AND LIABILITY MANAGEMENT

Asset and liability management is an integral part of managing a banking institution's primary source of income, net interest income. The Bank of Hemet manages the balance between rate-sensitive assets and rate-sensitive liabilities being repriced in any given period with the objective of stabilizing net interest income during periods of fluctuating interest rates. The Bank of Hemet considers its rate-sensitive assets to be those which either contain a provision to adjust the interest rate or mature within one year. These assets include loans and investment securities and federal funds sold. Rate-sensitive liabilities are those which allow for periodic interest rate changes within one year: they include maturing time certificates, savings deposits, money market and interest-bearing demand deposits. The difference between the aggregate amount of assets and liabilities that reprice or mature within various time frames is called the "gap." Generally, if repricing assets exceed repricing liabilities in a time period, The Bank of Hemet would be deemed to be asset-sensitive--a "positive gap." If repricing liabilities exceed repricing assets in a time period, The Bank of Hemet would be deemed to be liability-sensitive--a "negative gap." A positive gap will generally produce a higher net interest margin in a rising rate environment and a lower net interest margin in a declining rate environment. Conversely, a negative gap will generally produce a lower net interest margin in a rising rate environment and a higher net interest margin in a declining rate environment. However, because interest rates for different asset and liability products offered by depository institutions respond in a different manner, both in terms of the responsiveness, as well as the extent of responsiveness to changes in interest rate environment,

the gap is only a general indicator of interest sensitivity.

Generally, The Bank of Hemet seeks to maintain a balanced position in which there is a narrow range of asset or liability sensitivity within a one-year period. This kind of balanced position, in principle, should ensure net interest margin stability in times of volatile interest rates. This balanced position is accomplished through maintaining a significant level of loans, investment securities and deposits available for repricing or maturity within one year.

The following table sets forth the interest rate sensitivity of The Bank of Hemet's interest-earning assets and interest-bearing liabilities at December 31, 1998, using the interest rate

37

sensitivity gap ratio. For purposes of the following table, an asset or liability is considered rate-sensitive within a specified period when it can be repriced or matures within its contractual terms.

<TABLE>

<CAPTION>

<S>	AMOUNTS MATURING OR REPRICING					
	<C>	<C>	<C>	<C>	<C>	<C>
	WITHIN 3 MONTHS	AFTER 3 BUT WITHIN 12 MONTHS	AFTER 1 BUT WITHIN 5 YEARS	AFTER 5 YEARS	NONINTEREST-BEARING	TOTAL

<CAPTION>

<S>	(DOLLARS IN THOUSANDS)					
	<C>	<C>	<C>	<C>	<C>	<C>
<b>ASSETS</b>						
Federal funds sold.....	\$ 10,500	\$ --	\$ --	\$ --	\$ --	\$ 10,500
Investment securities.....	2,882	16,000	6,000	--	--	24,882
Loans (1).....	83,518	61,381	52,942	9,179	--	207,020
Other-interest bearing assets.....	5	--	--	--	--	5
Total earning assets.....	96,905	77,381	58,942	9,179	--	242,407
Noninterest-bearing assets and allowances for loan and lease losses.....	--	--	--	--	10,470	10,470
Total assets.....	\$ 96,905	\$ 77,381	\$ 58,942	\$ 9,179	\$ 10,470	\$ 252,877
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>						
Interest bearing demand, money market and savings deposits.....	\$ 71,389	\$ --	\$ --	\$ --	\$ --	\$ 71,389
Time deposits of \$100,000 or more.....	2,641	4,625	875	--	--	8,141
Time deposits under \$100,000.....	29,684	80,143	7,024	29	--	116,880
Other interest-bearing liabilities.....	--	--	--	--	--	--
Total interest bearing liabilities..	\$ 103,714	\$ 84,768	\$ 7,899	\$ 29	--	\$ 196,410
Other liabilities and shareholders' equity.....	--	--	--	--	56,467	56,467
Total liabilities and shareholders' equity.....	\$ 103,714	\$ 84,768	\$ 7,899	\$ 29	\$ 56,467	\$ 252,877
Incremental gap.....	\$ (6,809)	\$ (7,387)	\$ 51,043	\$ 9,150	\$ (45,997)	
Cumulative gap.....	\$ (6,809)	\$ (14,196)	\$ 36,847	\$ 45,997		
Cumulative gap/earning assets.....	(2.8%)	(5.9%)	15.2%	19.0%		
Cumulative gap/total assets.....	(2.7%)	(5.6%)	14.6%	18.2%		

</TABLE>

(1) Loan amounts do not include nonaccrual loans of \$1.6 million.

The majority of The Bank of Hemet's loan portfolio, excluding nonaccrual loans, continues to consist of floating or adjustable rate loans. The percentage of such loans decreased to 86.7% at December 31, 1998 from 87.5% at December 31, 1997. Noninterest bearing demand deposits as a percentage of total deposits increased to 14.8% at December 31, 1998 from 13.4% at December 31, 1997. The Bank of Hemet's policy is to maintain a ratio of rate sensitive assets less rate sensitive liabilities in a range between -10% and +10% of total assets for assets and liabilities repricing within three months, and after three months but within 12 months. At December 31, 1998, the amount of rate sensitive liabilities that reprice within one year exceeded rate sensitive assets by \$14.2 million, or negative 5.6% of total assets. In other words, The Bank of Hemet was liability-sensitive with a negative cumulative one-year gap of \$14.2 million at December 31, 1998. In general, based upon The Bank of



Hemet's mix of deposits, loans and investments, increases in interest rates would be expected to result in a decrease in The Bank of Hemet's net interest margin.

The interest rate gaps reported in the table above arise when assets are funded with liabilities having different repricing intervals. Since these gaps are actively managed and change daily as adjustments are made for changes in interest rates and market outlook, positions at the end of any period may not be reflective of The Bank of Hemet's interest rate sensitivity in subsequent periods. Active management dictates that longer-term economic views are balanced against prospects for short-term interest rate changes in all repricing intervals. For purposes of the analysis above, repricing of fixed-rate instruments is based upon the contractual maturity of the applicable instruments. Actual payment patterns may differ from contractual payment patterns. The change in net interest margin may not always follow the general expectations of an asset-sensitive or liability-sensitive balance sheet during periods of changing interest rates, because interest rates earned or paid may change by differing increments and at different time intervals for each type of interest-sensitive asset and liability. As a result of these factors, at any given time, The Bank of Hemet may be more sensitive or less sensitive to changes in interest rates than indicated in the above table.

#### MARKET RISK

Market risk is the risk of loss to future earnings, to fair values or to future cash flows that may result from changes in the price of a financial instrument. The value of a financial instrument may change as a result of changes in interest rate and other market changes. Market risk is attributed to all market risk sensitive financial instruments, including investment securities, loans, deposits and borrowings.

The Bank of Hemet does not engage in trading activities for its own account and does not participate in foreign currency transactions for its own account. Accordingly, The Bank of Hemet's exposure to market risk is primarily a function of its asset and liability management activities. The principal market risk to The Bank of Hemet is the interest rate risk inherent in its lending, investing and deposit-taking activities. This is because interest-earning assets and interest-bearing liabilities of the bank do not change at the same speed, to the same extent or on the same basis.

The Bank of Hemet's interest rate sensitivity analysis is discussed in the preceding section. The table on page 38 measures The Bank of Hemet's interest rate sensitivity gap, in other words, the difference between earning assets and liabilities maturing or repricing within specified periods. However, gap analysis has significant limitations as a method for measuring interest rate risk since changes in interest rates do not affect all categories of assets and liabilities in the same way or at the same time. Further, it has limitations in helping The Bank of Hemet to manage the difference in behavior of lending and funding rates--so-called "basis risk."

To address the limitations inherent in gap analysis, The Bank of Hemet monitors its expected change in earnings based on changes in interest rates through a detailed model. This model's estimate of interest rate sensitivity takes into account the differing time intervals and differing rate change increments of each type of interest-sensitive asset and liability. It then measures the projected impact of changes in market interest rates on The Bank of Hemet's return on equity. Based upon the December 31, 1998 mix of interest-sensitive assets and liabilities, given an immediate and sustained increase in the federal funds rate and other key rates indexes of 2%, this model estimates The Bank of Hemet's cumulative return on equity over the next year would increase by about .35%. However, the actual return on equity might decrease by about .35% in response to a 2% decrease in these key rates.

#### LIQUIDITY AND CAPITAL RESOURCES

**LIQUIDITY.** In order to maintain adequate liquidity, The Bank of Hemet must have sufficient resources available at all times to meet its cash flow requirements. The need for liquidity in a banking institution arises principally to provide for deposit withdrawals, the credit needs of its customers and to take advantage of investment opportunities as they arise. A financial institution may achieve desired liquidity from both assets and liabilities. The Bank of Hemet considers cash and deposits held in other banks, federal funds sold, other short term investments, maturing loans and investments, payments of principal and interest on loans and investments as sources of asset liquidity. The Bank of Hemet considers deposit growth and access to borrowing lines of credit and market sources of funds as sources of liability liquidity.

The Bank of Hemet reviews its liquidity position on a regular basis based upon its current position and expected trends as mentioned above. Liquid assets

include cash and deposits in other banks, unpledged securities and federal funds sold. The Bank of Hemet's liquid assets totaled \$31.9 million, or 12.6% of total assets at December 31, 1998, compared with \$37.4 million, or 15.5% of total assets at December 31, 1997. Liquidity is also affected by the collateral requirements of public deposits and certain borrowings. Total pledged securities were \$10.0 million at December 31, 1998 compared with \$7.0 million at December 31, 1997 and \$7.0 million at December 31, 1996.

Management believes that The Bank of Hemet maintains adequate sources of liquidity in the form of liquid assets and borrowing lines of credit to meet its current cash obligations for the next 12 months. The Bank of Hemet's liquidity might be insufficient if deposit withdrawals were to exceed anticipated levels. Deposit withdrawals can increase if an insured depository financial institution experiences financial difficulties or receives adverse publicity for other reasons, or if its pricing, products or services are not competitive with those offered by other institutions.

The Bank of Hemet's primary sources of liquidity include liquid assets and a stable deposit base. To supplement these, The Bank of Hemet maintains a borrowing line of credit with the Federal Home Loan Bank of San Francisco in the amount of \$14.2 million as of December 31, 1998. This line is secured by approved residential and commercial real estate mortgage loans totaling \$21.3 million as of December 31, 1998. At December 31, 1998, there were no advances outstanding under this line of credit, and the line was not used during 1998. Additionally, The Bank of Hemet has available reverse repurchase agreement lines of credit with two broker-dealers. These lines are subject to normal terms for such arrangements and were not used during 1998 or 1996. In 1997, the average amount outstanding under them was \$249,000, and the maximum amount outstanding was \$3.9 million. At December 31, 1998, marketable securities with a market value of approximately \$14.0 million were available for the reverse repurchase lines of credit. In April 1999, The Bank of Hemet obtained approval to borrow under the Discount Window Program of the Federal Reserve Bank of San Francisco. There have been no advances under this program.

CAPITAL. Capital serves as a source of funds and helps protect creditors and uninsured depositors against potential losses. The primary source of capital for The Bank of Hemet has been internally generated capital through retained earnings. The Bank of Hemet's shareholders' equity increased \$796,000, or 3.9%, to \$21.0 million at December 31, 1998 from \$20.2 million at December 31, 1997. The increase resulted from net income of \$2.8 million, partially offset by dividends of \$2.0 million.

40

In May 1997, The Bank of Hemet concluded an issuer tender offer, which resulted in the repurchase of 50,626 shares of common stock at the offering price of \$27.00 a share, for a total of \$1.4 million.

Federal regulations establish guidelines for calculating risk-adjusted capital ratios. These guidelines establish a systematic approach of assigning risk weights to bank assets and off-balance sheet items making the regulatory capital requirements more sensitive to differences in risk profiles among banking organizations. Under these regulations, banks are required to maintain a total risk-based capital ratio of 8.0%; that is, "Tier 1" plus "Tier 2" capital must equal at least 8.0% of risk-weighted assets plus off-balance sheet items, and Tier 1 capital consisting of primarily shareholders' equity must constitute at least 50% of qualifying capital. Tier 1 capital consists primarily of shareholders' equity excluding goodwill, and Tier 2 capital includes subordinated debt and, subject to a limit of 1.25% of risk-weighted assets, the allowance for loan and lease losses.

At December 31, 1998, The Bank of Hemet had a Tier 1 risk-based capital ratio of 9.99% and a total risk-based capital ratio of 11.06%. In addition, regulators have adopted a minimum leverage capital ratio standard. This standard is designed to ensure that all financial institutions, irrespective of their risk profile, maintain minimum levels of core capital, which by definition excludes the allowance for loan and lease losses. These minimum standards for top-rated institutions may be as low as 3%; however, regulatory agencies have stated that most institutions should maintain ratios at least 1 to 2 percentage points above the 3% minimum. At December 31, 1998, the Bank's leverage capital ratio equaled 8.31%.

Banks with Tier 1 risk-based capital of 6.0%, total-risk-based capital of at least 10.0% and a leverage capital ratio of at least 5% are considered "well capitalized" by federal banking agencies.

The Bank of Hemet's policy is not to declare any dividends that would cause its leverage capital ratio to be below 8.00% or its total risk-based capital ratio to be below 10%.

The following table summarizes the minimum capital ratios required by current Federal Deposit Insurance Corporation regulations, the ratios at which a bank is considered well-capitalized by the Federal Deposit Insurance Corporation, and the capital ratios of The Bank of Hemet at December 31, 1998,

<TABLE>  
<CAPTION>

	REGULATORY CAPITAL REQUIREMENTS		THE BANK OF HEMET AT			
			DECEMBER 31,			
	MINIMUM	WELL-CAPITALIZED	MARCH 31, 1999	1998	1997	1996
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Tier-1 risk-based capital.....	4.0%	6.0%	10.01%	9.99%	10.43%	10.77%
Total risk-based capital.....	8.0%	10.0%	11.06%	11.06%	11.53%	11.97%
Leverage capital ratio(1).....	4.0%	5.0%	8.31%	8.31%	8.53%	8.66%

</TABLE>

(1) Tier 1 capital to total quarterly average assets.

Failure to meet minimum capital requirements can trigger mandatory actions by the regulators that, if undertaken, could have a material effect on The Bank of Hemet's financial statements and operations.

41

#### IMPACT OF INFLATION

The financial statements and related financial data presented in this prospectus have been prepared in accordance with generally accepted accounting principles, which require the measurement of financial position and operating results in terms of historical dollars without considering changes in the relative purchasing power of money over time due to inflation. Unlike most industrial companies, virtually all of the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates are likely to have a more significant impact on a financial institution's performance than the effects of general levels of inflation. During periods of inflation, interest rates do not necessarily move in the same direction or with the same magnitude as the price of goods and services. The Bank of Hemet seeks to manage its interest sensitivity gap to minimize the potential adverse effect of inflation and other market forces on its net interest income and capital.

Financial institutions are also affected by inflation's impact on noninterest expenses, such as salaries and occupancy expenses. During 1996, 1997 and 1998, inflation remained relatively stable, and The Bank of Hemet's level of noninterest expense was relatively unaffected by inflation.

#### IMPACT OF RECENT ACCOUNTING PRONOUNCEMENTS

In June 1997, the Financial Accounting Standards Board issued SFAS No. 130, "Reporting Comprehensive Income." This statement provides that all enterprises report comprehensive income as a measure of overall performance. This new standard is effective for 1998 and did not have a material effect on the current disclosures of The Bank of Hemet.

In June 1997, the Financial Accounting Standards Board issued SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information." This statement changes the way public companies report selected information about segments of their business in their annual financial statements and require them to report selected segment information in their quarterly reports issued to shareholders. This new standard is effective for 1998 and did not have a material effect on the current disclosures of The Bank of Hemet.

In June 1998, the Financial Accounting Standards Board issued SFAS 133, "Accounting for Derivative Instruments and Hedging Activities." This statement establishes accounting and reporting standards for derivative instruments and for hedging activities. This new standard is effective for 2000 and is not expected to have a material impact on the financial statements of The Bank of Hemet.

In October 1998, the Financial Accounting Standards Board issued SFAS No. 134, "Accounting for Mortgage-Backed Securities Retained after the Securitization of Mortgage Loans Held for Sale by a Mortgage Banking Enterprise." SFAS No. 134 amends SFAS No. 65, "Accounting for Certain Mortgage Banking Activities," which establishes accounting and reporting standards for activities of mortgage banking enterprises and other enterprises that conduct operations that are substantially similar. SFAS No. 134 requires that after the securitization of mortgage loans held for sale, the resulting mortgage-backed securities and other retained interests should be classified in accordance with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities," based on its ability and intent to sell or hold these investments. This new standard is effective for 1999 and is not expected to have a material impact on the financial statements of The Bank of Hemet.

## YEAR 2000 COMPLIANCE

OVERVIEW. The Year 2000 problem arises when computer programs have been written using two digits rather than four to define the applicable year. As a result, date-sensitive hardware and software may recognize a date using "00" as the year 1900 rather than the year 2000. This could result in a system failure or other disruption of operations and impede normal business activities.

In June 1996, the Federal Financial Institutions Examination Council alerted the banking industry of the serious challenges that would be encountered with Year 2000 issues. The Federal Deposit Insurance Corporation has also implemented a plan to require compliance with Year 2000 issues and regularly examines the progress of banks, including The Bank of Hemet and its subsidiary, BankLink Corporation.

## STATE OF READINESS OF THE BANK OF HEMET AND BANKLINK CORPORATION.

OVERALL PLAN. In accordance with FDIC guidelines, The Bank of Hemet and BankLink Corporation have developed a comprehensive plan to deal with the Year 2000 issue. The Bank of Hemet and BankLink Corporation believe the plan, if properly implemented, will result in timely and adequate modifications of its systems and technology and those of its outside vendors to address Year 2000 issues appropriately. The plan has five phases:

- Awareness--defining the Year 2000 problem, gaining support and resources, developing a plan, and establishing a project team.
- Assessment--assessing the size and complexity of the project, and identifying all systems affected by the Year 2000 date change.
- Renovation--hardware and software upgrades, and outside vendor certifications.
- Validation--testing systems including connections with other systems, and acceptance of such by internal and external users.
- Implementation--developing a contingency plan.

Except as indicated hereafter, The Bank of Hemet has substantially completed the five phases of its plan. However, to ensure success, The Bank of Hemet plans to:

- engage in ongoing discussions with outside vendors to determine if they have been successful in validating their compliance with their Year 2000 plans;
- use its best efforts to ensure that new systems or subsequent changes in existing systems are verified as Year 2000 compliant;
- test certain third-party systems which have computerized interfaces with The Bank of Hemet and BankLink Corporation's systems; and
- continue to refine its contingency plan.

The Bank of Hemet and BankLink Corporation rely substantially on outside vendors to provide computer hardware and software systems for their operations. Consequently, the Year 2000 plan places heavy emphasis on compliance by outside vendors. The plan prioritizes outside vendors by the degree of dependence on the computer systems they provide. The plan also addresses customer capabilities to become Year 2000 compliant. Finally, the plan requires review of non-information technology systems, such as alarm systems.

The Bank of Hemet's Audit Committee has engaged the services of an independent consultant to review the overall Year 2000 project. The consultant has been requested to emphasize testing of vendor-reliant, mission-critical systems and to assist in the development of a contingency plan.

VENDORS. The Bank of Hemet and BankLink Corporation rely heavily on outside vendors to provide the hardware and software used in their computer operations. To determine the readiness of outside vendors, The Bank of Hemet and BankLink Corporation have solicited written communications from each major outside vendor about its compliance with Year 2000. Most outside vendors have responded that they are Year 2000 compliant. The Bank of Hemet identified a total of 45 vendors. It found that 34 of them were not critical to The Bank of Hemet's operations. The bank found the remaining 11 vendors to be critical to its operations, and found all 11 Year 2000 compliant. For those outside vendors who provide critical systems and have certified these systems as Year 2000 compliant, The Bank of Hemet and BankLink Corporation have conducted in-house testing of these systems, using various Year 2000-critical dates. The testing has included the creation of a duplicate database on BankLink Corporation's

mainframe computer used for Year 2000 testing purposes.

For those outside vendors that have responded they are working toward Year 2000 compliance and that The Bank of Hemet and BankLink Corporation have determined to be significant, The Bank of Hemet and BankLink Corporation will follow up on a regular basis throughout 1999. These outside vendors have advised The Bank of Hemet and BankLink Corporation that they expect to be Year 2000 compliant prior to December 31, 1999, and there are no Year 2000 compliance issues which appear to be unresolvable by that date. For such outside vendors that provide critical systems, The Bank of Hemet and BankLink Corporation will be conducting ongoing testing to validate Year 2000 compliance.

The Bank of Hemet and BankLink Corporation have determined that other outside vendors will not have a material impact on their operations, whether or not they are Year 2000 compliant.

**CUSTOMERS.** The Bank of Hemet has sent a questionnaire to each of its significant borrowers and depositors to determine the extent of risk created by any failure by them to remediate their own Year 2000 issues. The Bank of Hemet's customer risk evaluation consisted of sending questionnaires to its 22 largest business deposit customers and its 95 largest borrowers, which each had loans in excess of \$500,000. Most customers have responded from the questionnaires, The Bank of Hemet identified several of these customers as having a low risk of Year 2000 exposure due to the commercial real estate nature of their businesses. There was one borrower whose response raised a question about its Year 2000 risk. The Bank of Hemet has placed this loan on an internal loan watch list and the loan officer is monitoring it. Each borrower and depositor is categorized according to its state of readiness based on its response to the questionnaire and The Bank of Hemet's review of the customer. The Bank of Hemet has also taken steps to ensure liquidity for depositors with high Year 2000 risks. It will make a reassessment on each customer's risk on a regular basis. BankLink Corporation has organized a client bank information group to exchange Year 2000 readiness and testing information.

**NON-INFORMATION TECHNOLOGY SYSTEMS.** The Bank of Hemet and BankLink Corporation have tested their non-information technology systems, such as microprocessors controlling its environmental and alarm systems, and found them to be Year 2000 compliant.

44

**COSTS TO ADDRESS YEAR 2000 ISSUES FOR THE BANK OF HEMET AND BANKLINK CORPORATION.** Some of The Bank of Hemet's and BankLink Corporation's computer hardware and software applications were modified or replaced in order to maintain their functionality as the year 2000 approaches. The Bank of Hemet and BankLink Corporation have spent approximately \$120,000 as of December 31, 1998 to address Year 2000 issues. The Bank of Hemet and BankLink Corporation spent \$34,000 in the first quarter of 1999 to address Year 2000 issues and estimates their total expenditures over the two-year period 1998 through 1999 to be approximately \$200,000. This estimate includes some costs, such as the purchase of computer hardware and software upgrades, that will qualify as depreciable assets for accounting purposes, with the related depreciation expense recognized over the estimated useful lives of the applicable assets. However, the majority of costs, including in-house staff time, will be expensed as incurred, in compliance with generally accepted accounting principles. BankLink Corporation expects to recover a portion of its total costs by recognizing non-interest income over the fifteen month period ending December 31, 1999 from fees charged to its client banks for Year 2000 testing and other costs incurred. The Bank of Hemet does not anticipate that any of these costs will materially impact its consolidated results of operations in any one reporting period.

In light of the complexity of the Year 2000 problem and its potential impact on both The Bank of Hemet and BankLink Corporation and third parties that interact with them, there can be no assurance that the costs associated with the Year 2000 issue will be as estimated. The Bank of Hemet and BankLink Corporation do not intend to obtain insurance against any Year 2000 risks.

**RISKS OF THE YEAR 2000 ISSUES FOR THE BANK OF HEMET AND BANKLINK CORPORATION.** Management believes that it is likely that the foregoing efforts will be successful. However, it is possible that necessary remediation of vendor-reliant systems may not be completed in a timely manner, or third-party systems with which The Bank of Hemet and BankLink Corporation have computerized interfaces may create Year 2000 issues. It is also possible that the expenses or liabilities to which The Bank of Hemet and BankLink Corporation may become subject as a result of such issues could be material. Any such event or occurrence could have a material adverse effect on The Bank of Hemet's and BankLink Corporation's business, prospects, operating results and financial condition. Ultimately, the potential impact of the Year 2000 issue on The Bank of Hemet and BankLink Corporation will depend on a series of complex factors, including the following:

- the corrective measures undertaken by The Bank of Hemet and BankLink Corporation themselves;

- the measures undertaken by outside vendors to become Year 2000 compliant;
- the accuracy of representations made by outside vendors to The Bank of Hemet and BankLink Corporation concerning their state of readiness;
- the degree of compliance by governmental agencies, businesses, telephone and other utility companies, and other entities which engage in essential communications or third-party computerized interfaces with The Bank of Hemet and BankLink Corporation and its customers; and
- the degree of compliance by customers.

45

At worst, The Bank of Hemet's and BankLink Corporation's customers and outside vendors will face severe Year 2000 issues. Large customers negatively affected by Year 2000 issues could lead to deposit outflows or increased risk in collecting loans. The Bank of Hemet and BankLink Corporation may also be required to replace noncompliant outside vendors with more expensive Year 2000 compliant outside vendors.

The Bank of Hemet and BankLink Corporation have taken steps to avail themselves of the safe harbor provision of the newly enacted Year 2000 Information and Readiness Disclosure Act by clearly labeling written communications to customers and vendors as a "Year 2000 Readiness Disclosure," thereby promoting a prompt, candid and thorough exchange of information on Year 2000 readiness and limiting liability for any errors.

CONTINGENCY PLANS OF THE BANK OF HEMET AND BANKLINK CORPORATION. The Bank of Hemet and BankLink Corporation have created a contingency plan to take effect should there be circumstances preventing timely implementation. If those outside vendors do not demonstrate compliance by a specified date, The Bank of Hemet and BankLink Corporation will seek alternatives in accordance with its contingency plan. Outside vendors of mission critical systems are major U.S. companies, and management has assessed the relevant financial and operational capabilities of their hardware and software to provide Year 2000 processing. The time frame to convert to another outside vendor in the Year 2000 is relatively long, and therefore the ability to obtain replacement outside vendors will be limited.

In addition, for each mission critical system, The Bank of Hemet and BankLink Corporation have identified alternate procedures to achieve a successful resumption of business in case its computer systems, or those of its mission critical outside vendors, fail. The alternative procedures include development of a manual process for implementing the system and identifying alternative outside vendors.

#### BUSINESS OF THE BANK OF HEMET

##### GENERAL

The Bank of Hemet is a California community bank headquartered in Hemet, California. In addition to its headquarters, The Bank of Hemet maintains five branches in Riverside county. Riverside county and neighboring San Bernardino county are experiencing significant population and economic growth.

The Bank of Hemet's primary service area is the area of California commonly referred to as the Inland Empire, a region primarily consisting of Riverside and San Bernardino counties. These counties are experiencing significant population and economic growth, much of which management believes is fueled by the migration of manufacturing, distribution and export service firms from adjacent Los Angeles, Orange and San Diego counties.

The Bank of Hemet was incorporated in 1974 under the California General Corporation Law and is licensed by the California Department of Financial Institutions to conduct a general banking business. The Federal Deposit Insurance Corporation insures its deposits up to the applicable legal limits. The Bank of Hemet is not a member of the Federal Reserve System.

The Bank of Hemet emphasizes community-based commercial banking. It serves small-to-medium size businesses, professionals, retired individuals and residents in the Hemet area, as well as businesses and real estate owners/developers primarily throughout Riverside,

46

San Bernardino, Orange, Los Angeles and San Diego counties. The Bank of Hemet also makes commercial real estate loans meeting its underwriting criteria in the San Francisco bay area, in the Sacramento area and in other areas outside of its primary service area, including Arizona.

The Bank of Hemet offers a full range of commercial, real estate, personal, home improvement, automobile and other installment and term loans. The Bank of Hemet's primary lending focus has historically been and continues to be commercial real estate and construction lending.

Deposit services offered by The Bank of Hemet include personal and business checking and savings accounts, money market deposit accounts, certificates of deposit, and individual retirement accounts. Other operational services include safe deposit boxes, travelers checks, wire transfers, overdraft lines of credit, electronic banking for businesses, 24-hour telephone banking, merchant bankcard, automated clearing house origination, automatic teller machines on the Instant Teller and Cirrus networks and other standard depository functions.

As of December 31, 1998, The Bank of Hemet's wholly owned subsidiary, BankLink Corporation, provides data processing services to The Bank of Hemet and seven other banks and item processing services to The Bank of Hemet and three other banks. At December 31, 1998, BankLink Corporation had total assets of \$931,000 and pre-tax earnings for the year ended December 31, 1998 of \$146,000. The Bank has four other subsidiaries that are not active.

#### BUSINESS STRATEGY

The Bank of Hemet's business strategy is to:

- maintain asset quality;
- increase the volume and diversity of good quality, mini-perm real estate and commercial loans;
- remix its deposit base to lower its cost of funds;
- provide high quality value based banking services and products to its customers;
- continue a pace of moderate growth; and
- increase operating efficiencies.

The Bank of Hemet has focused on, and will continue to focus on, marketing efforts to implement its business strategy. These efforts include obtaining increased loan and deposit business from existing customers, word-of-mouth referrals, advertising and personal solicitation of customers by officers, directors and stockholders. Management assigns responsibility to all loan and business development officers to make regular calls on potential customers and obtain referrals from existing customers. The Bank of Hemet directs promotional efforts toward individuals and small-to-medium sized businesses.

In connection with Pacific Community Banking Group's acquisition of The Bank of Hemet, during the fourth quarter of 1998, The Bank of Hemet provided to Pacific Community Banking Group its budget for 1999. This budget included estimates of various categories of income and expenses, all of which were consistent with its 1998 experience.

47

#### PREMISES

The following table sets forth information about The Bank of Hemet's banking offices.

<TABLE>

<CAPTION>

LOCATION	TYPE OF OFFICE	OWNED/ LEASED	SIZE	SINCE
<S>	<C>	<C>	<C>	<C>
1600 East Florida Avenue, Hemet.....	Main branch	Leased	7,200 sq./ft	1988
1555 W. Florida Avenue, Hemet.....	Branch	Leased	5,300 sq./ft	1986
1497 S. San Jacinto Street, San Jacinto.....	Branch	Leased	3,300 sq./ft	1992
56525 Highway 371, Anza.....	Branch	Owned	1,920 sq./ft	1992
3545 Central Avenue, Riverside.....	Branch(1)	Leased	4,600 sq./ft	1993
3715 Sunnyside Drive, Riverside.....	Branch and Administrative offices(2)	Owned	7,100 sq./ft(3)	1993

</TABLE>

- (1) The bank does not currently accept deposits at this location. These are the premises of The Bank of Hemet's wholly owned data processing subsidiary, BankLink Corporation.
- (2) These premises are occupied by The Bank of Hemet's loan department, note department, and finance department.
- (3) Includes enclosed parking area.

Aggregate annual rentals for The Bank of Hemet and its subsidiaries for

leased premises were \$376,000 for the year ended December 31, 1998.

INVESTMENT PORTFOLIO

The following table sets forth the book values of securities at the dates indicated. Under SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities," The Bank of Hemet has designated all of its U.S. government securities and other securities as "held-to-maturity." The Bank of Hemet does not have any tax exempt securities in its investment portfolio.

<TABLE>  
<CAPTION>

	1998	1997	1996
	(DOLLARS IN THOUSANDS)		
<S>	<C>	<C>	<C>
U.S. government agencies(1).....	\$ 24,000	\$ 24,000	\$ 23,996
Other securities(2).....	882	833	783
Total.....	\$ 24,882	\$ 24,833	\$ 24,779

</TABLE>

(1) At December 31, 1998, \$10.0 million of these securities were pledged to secure public funds deposited with The Bank of Hemet, compared with \$7.0 million at December 31, 1997 and \$7.0 million at December 31, 1996.

(2) Consists of perpetual preferred stock of the Federal Home Loan Bank of San Francisco.

The following table sets forth the maturities of The Bank of Hemet's investment securities at December 31, 1998 and the weighted average yields of those securities calculated on the basis of the cost and effective yields based on the scheduled maturity of each security.

<TABLE>  
<CAPTION>

	ONE YEAR OR LESS		AFTER ONE TO FIVE YEARS		AFTER FIVE TO TEN YEARS		AFTER TEN YEARS	
	AMOUNT	YIELD	AMOUNT	YIELD	AMOUNT	YIELD	AMOUNT	YIELD
	(DOLLARS IN THOUSANDS)							
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
U.S. government agencies.....	\$ 18,000	5.08%	\$ 6,000	5.04%	--	--%	\$ --	--%
Other securities(1).....	--	--	--	--	--	--	882	5.86
Total.....	\$ 18,000	5.08%	\$ 6,000	5.04%	--	--%	\$ 882	5.86%
Estimated fair value.....	\$ 18,005		\$ 5,997				\$ 882	

<CAPTION>

	TOTAL	
	AMOUNT	YIELD
<S>	<C>	<C>
U.S. government agencies.....	\$ 24,000	5.07%
Other securities(1).....	882	5.86
Total.....	\$ 24,882	5.09%
Estimated fair value.....	\$ 24,884	

</TABLE>

(1) Consists of perpetual preferred stock of the Federal Home Loan Bank of San Francisco.

The Bank of Hemet does not own securities of a single issuer, except for securities issued by U.S. government agencies, whose aggregate book value is in



excess of 10% of its total equity.

LENDING ACTIVITIES

The Bank of Hemet originates loans for its own portfolio. Lending activities include commercial real estate mortgage, real estate construction, commercial and consumer loans. The Bank of Hemet's primary asset category continues to be its loan portfolio, which comprised 79.2% of average total assets in 1998. At December 31, 1998, The Bank of Hemet had no foreign loans outstanding and has not engaged in the business of making foreign loans.

LOAN PORTFOLIO

COMPOSITION OF LOANS. The following table shows the composition of loans by type of loan or type of borrower at the dates indicated.

<TABLE>  
<CAPTION>

	DECEMBER 31,				
	1998	1997	1996	1995	1994
	(IN THOUSANDS)				
<S>	<C>	<C>	<C>	<C>	<C>
Real estate--construction.....	\$ 1,941	\$ 6,627	\$ 8,268	\$ 12,169	\$ 6,885
Real estate--mortgage(1).....	195,248	174,897	167,979	163,684	164,784
Commercial.....	10,016	10,033	10,401	8,525	11,762
Consumer.....	1,002	1,065	1,043	1,264	1,542
Municipal leases.....	--	--	24	292	833
All other loans.....	391	411	482	489	761
Total loans.....	208,598	193,033	188,197	186,423	186,567
Deferred origination fees.....	(796)	(746)	(756)	(706)	(821)
Total loans.....	\$ 207,802	\$ 192,287	\$ 187,441	\$ 185,717	\$ 185,746

</TABLE>

(1) Includes commercial real estate and residential mortgage loans.

MATURITIES AND SENSITIVITIES OF LOANS TO CHANGES IN INTEREST RATES. The following table shows the maturity distribution of the loan portfolio excluding nonaccrual loans and deferred origination fees at December 31, 1998, and the loan portfolio's sensitivity to changes in interest rates. The principal balances of loans due after one year are indicated by both fixed and floating rate categories.

<TABLE>  
<CAPTION>

	WITHIN ONE YEAR	AFTER ONE BUT WITHIN FIVE YEARS	AFTER FIVE YEARS	FLOATING RATE: DUE AFTER ONE YEAR	FIXED RATE: DUE AFTER ONE YEAR (1)
<S>	<C>	<C>	<C>	<C>	<C>
	(IN THOUSANDS)				
Real estate--construction.....	\$ 1,941	\$ --	\$ --	\$ --	\$ --
Real estate--mortgage.....	10,786	89,783	93,101	162,982	19,902
Commercial.....	7,449	2,568	--	2,035	533
Consumer.....	491	353	158	36	475
Municipal leases.....	--	--	--	--	--
All other loans.....	391	--	--	--	--
Total.....	\$ 21,058	\$ 92,704	\$ 93,259	\$ 165,053	\$ 20,910

</TABLE>

(1) Includes real estate mortgage floating rate loans of \$8,773,000 which are accruing interest at floor rates.

LOANS SECURED BY REAL ESTATE

At December 31, 1998, \$197.2 million, or approximately 94.5% of The Bank of Hemet's loans were secured by first deed of trust on real estate. The concentration in loans secured by real estate is monitored on a quarterly basis

and taken into account in the computation of the adequacy of the allowance for loan and lease losses. The non-residential real estate loan portfolio is segregated into various categories on which annual concentration limits are recommended by management and approved by the board of directors. The categories include

industrial, medical office, commercial office, mini-storage and retail. "Retail" is further broken down into subcategories, including anchored, automotive, office and strip center. Additionally, The Bank of Hemet categorizes the portfolio geographically by state and county.

The three largest categories of loans secured by real estate are shown in the following table:

<TABLE>  
<CAPTION>

TYPE OF REAL ESTATE LOAN	AMOUNT AT DECEMBER 31, 1998	PERCENTAGE OF LOANS IN PORTFOLIO
	(DOLLARS IN THOUSANDS)	
<S>	<C>	<C>
Commercial mortgage loans.....	\$ 166,179	79.7%
Residential mortgage loans.....	29,069	13.9
Construction loans.....	1,941	0.9
Total real estate loans.....	\$ 197,189	94.5%

</TABLE>

COMMERCIAL MORTGAGE LOANS. The Bank of Hemet provides intermediate term commercial real estate loans collateralized by first deeds of trust on real property. Approximately one percent of the commercial mortgage portfolio consists of loans made outside California. Within California, at December 31, 1998, approximately 43% of commercial mortgage loans were secured by real property in Riverside county, 28% in Orange county, 11% in San Bernardino county and 7% in Los Angeles county.

The value of real estate collateral is supported by formal appraisals in compliance with applicable federal regulations. Generally, these types of loans are made for a period of up to five years, loan-to-value ratios are 65% or less, and debt coverage ratios, 1.30:1 or better. The loans generally carry adjustable interest rates indexed to the one-year or, to a lesser extent, the three- or five-year Treasury constant maturity index. Rate adjustments vary from quarterly to five years. Amortization may be up to 30 years.

Repayment on loans secured by such properties depends on successful operation and management of the collateral properties. The value of the collateral is also subject to the real estate market and general economic conditions. The Bank of Hemet attempts to address these risks through its underwriting criteria, including the loan-to-value ratios and debt service coverages described above. The collateral quality and type must meet The Bank of Hemet's standards, the property generally must have quality leases extended beyond the maturity date, if applicable, and the borrower/guarantor generally must have strong liquidity. The Bank of Hemet generally requires continuing guaranties from borrowers/owners. The Bank of Hemet's lending personnel inspects all of the properties securing The Bank of Hemet's real estate portfolio before the loan is made.

The Bank of Hemet requires title insurance insuring the status of its lien on all of the real estate secured loans. The Bank of Hemet also requires the borrower to maintain fire, extended coverage casualty insurance and, if the property is in a flood zone, flood insurance in amounts equal to the outstanding loan balance, subject to applicable law that may limit the amount of hazard insurance a lender can require to the cost of replacing improvements.

RESIDENTIAL MORTGAGE LOANS. As of December 31, 1998, the total of all residential mortgage loans held in portfolio by The Bank of Hemet was \$29.1 million, or 13.9% of total loans. The portfolio is primarily secured by first deeds of trust on single-family residences located in

the Riverside and San Bernardino counties of California. Approximately \$25.1 million or 86.4% of this portfolio consists of variable rate loans.

From time to time, The Bank of Hemet has originated first mortgages for resale on the secondary market to Federal Home Loan Mortgage Corporation and Federal National Mortgage Association. However, since 1995 The Bank of Hemet has chosen not to originate residential mortgage loans either for its own portfolio or for sale in the secondary market due to competitive issues. The Bank of Hemet

retains the servicing rights to the loans sold. Servicing arrangements provide for The Bank of Hemet to maintain records related to the servicing agreement, to assume responsibility for billing mortgagors, to collect periodic mortgage payments, and to perform various other activities necessary to the mortgage servicing function. The Bank of Hemet receives as compensation a servicing fee based on the principal balance of the outstanding loans. Servicing fee income amounted to \$57,000 during 1998, and the total unpaid principal balance of the mortgage servicing portfolio amounted to approximately \$18.3 million at December 31, 1998.

REAL ESTATE CONSTRUCTION LOANS. The Bank of Hemet finances the construction of residential, commercial and industrial properties. The Bank of Hemet's construction loans typically have the following characteristics:

- First mortgages on the collateral real estate;
- Maturities of one year or less;
- A floating rate of interest based on the Bank of America prime rate;
- Minimum cash equity of 30% of project cost;
- Reserve for anticipated interest costs during construction;
- Loan-to-value ratios generally not exceeding 65%; and
- Recourse against the borrower or a guarantor in the event of a default.

For commercial and industrial properties, The Bank of Hemet typically issues a stand-by commitment for a "take-out" mini-perm loan on the property. The Bank of Hemet does not participate in joint ventures or take an equity interest in connection with its construction lending.

Construction loans involve additional risks compared with loans secured by existing improved real property. These include:

- The uncertain value of the project prior to completion;
- The inherent uncertainty in estimating construction costs;
- Possible difficulties encountered by municipal or other governmental regulation during construction; and
- The inherent uncertainty of the market value of the completed project.

As a result of these uncertainties, repayment depends, in large part, on the success of the ultimate project. If The Bank of Hemet is forced to foreclose on a project before or at completion because of a default, The Bank of Hemet may not be able to recover all of the unpaid balance of the loan and its accrued interest, as well as the related foreclosure and

52

holding costs. In addition, The Bank of Hemet may find it necessary to pay additional amounts to complete a project and may have to hold the property for an indeterminate time. Further, future local or national economic trends could have an adverse impact on the potential success of construction projects financed by The Bank of Hemet and on collateral securing these loans.

#### COMMERCIAL LOANS

At December 31, 1998, approximately \$10.0 million, or 4.8% of The Bank of Hemet's total loan portfolio, consisted of commercial loans. The Bank of Hemet provides intermediate and short-term commercial loans that are either unsecured, partially secured or fully secured. The majority of these loans are in Riverside and San Bernardino counties. Loan maturities range up to five years. The Bank of Hemet requires re-analysis before making a loan extension in excess of 90 days. The Bank of Hemet makes these loans to individuals, professionals and businesses. The Bank of Hemet takes collateral whenever possible regardless of the loan purpose. Collateral may include cash, liens on accounts receivable and/or equipment. As a matter of policy, the Bank requires all principals of a business to be guarantors on all commercial loans. All borrowers must demonstrate the ability to service and repay not only The Bank of Hemet debt but all outstanding debt, on the basis of historical cash flow or conversion of assets.

#### CONSUMER LOANS

As of December 31, 1998, the total of all consumer loans held by The Bank of Hemet was \$1.0 million or .5% of total loans. Consumer loans may be secured or unsecured, and are extended for a variety of purposes, including the purchase or finance of automobiles, home improvement, home equity lines and overdraft protection. Consumer loan underwriting standards include an examination of the applicant's credit history and payment record on other debts and an evaluation

of his or her ability to meet existing obligations and payments on the proposed loan. Although creditworthiness of the applicant is of primary importance, the underwriting process also includes a comparison of the value of the security, if any, to the proposed loan amount.

Consumer loans entail greater risk than do residential mortgage loans, particularly in the case of consumer loans that are unsecured or secured by rapidly depreciating assets such as automobiles. In such cases, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment of the outstanding loan balance because the collateral is more likely to suffer damage, loss or depreciation. The remaining deficiency often does not warrant further collection efforts against the borrower beyond obtaining a deficiency judgment. In addition, consumer loan collections are dependent on the borrower's continuing financial stability. Furthermore, various federal and state laws, including federal and state bankruptcy and insolvency laws, often limit the amount that the lender can recover on these loans.

OFF-BALANCE SHEET COMMITMENTS

The Bank of Hemet may issue formal commitments or lines of credit to a limited number of well-established, financially responsible, local commercial enterprises. Such commitments can be either secured or unsecured. These commitments may take the form of revolving lines

53

of credit, letters of credit, real estate construction or real estate mortgage loans. Standby letters of credit are conditional commitments issued by The Bank of Hemet to guarantee the performance of a customer to a third party. The Bank of Hemet does not enter into any interest rate swaps or caps, or forward or future contracts.

The following table shows the distribution of The Bank of Hemet's undisbursed loan commitments at the dates indicated.

<TABLE>  
<CAPTION>

	AT DECEMBER 31,	
	1998	1997
	(IN THOUSANDS)	
<S>	<C>	<C>
Real estate--construction.....	\$ 2,404	\$ 2,160
Real estate--mortgage.....	1,472	822
Standby letters of credit.....	1,116	282
Undisbursed lines of credit.....	5,876	6,436
Total.....	\$ 10,868	\$ 9,700

</TABLE>

LENDING PROCEDURES AND CREDIT APPROVAL PROCESS

The board of directors' loan committee approves all loans in excess of \$500,000 and reviews all loans in excess of \$100,000. Lending limits are authorized by the loan committee through authority delegated by the board of directors of The Bank of Hemet. The directors' loan committee approves all loans which would create a total borrower liability in excess of \$500,000. The Chief Credit Officer is responsible for evaluating the authority limits for individual credit officers and recommends lending limits to the board of directors for approval.

The highest individual lending authority in The Bank of Hemet is currently \$500,000, which requires the approval and signature of the Chief Credit Officer. The second highest lending authority is \$150,000 for the manager of the real estate loan department. All other individual lending authorities are less, with the next largest authority being \$100,000.

At December 31, 1998, The Bank of Hemet's authorized legal lending limits were approximately \$3.5 million for unsecured loans and approximately \$5.8 million for secured loans. Legal lending limits are calculated in conformance with California law, which prohibits a bank from lending to any one individual or entity or its related interests an aggregate amount which exceeds 15% of primary capital plus the allowance for loan and lease losses on an unsecured basis and 25% on a secured basis. The Bank of Hemet's primary capital plus allowance for loan and lease losses at December 31, 1998 totaled \$23.3 million. The Bank of Hemet's largest borrower as of December 31, 1998 had an aggregate loan liability totaling \$5.8 million.

The Bank of Hemet seeks to mitigate the risks inherent in its loan portfolio by adhering to certain underwriting practices. These practices include analysis of prior credit histories, financial statements, tax returns and cash flow

projections, valuation of collateral based on reports of independent appraisers and verification of liquid assets. Although management believes that its underwriting criteria are appropriate for the various kinds of loans it makes, The Bank of Hemet may incur losses on loans which meet its underwriting criteria, and these losses may exceed the amounts set aside as reserves for such losses in the allowance for loan and lease losses.

ASSET QUALITY

NONPERFORMING ASSETS. Nonperforming assets include nonperforming loans and other real estate owned or OREO.

NONPERFORMING LOANS.

Nonperforming loans are those which the borrower fails to perform in accordance with the original terms of the obligation and fall into one of two categories:

- Nonaccrual loans. The Bank of Hemet generally places loans on nonaccrual status when interest or principal payments become 90 days or more past due unless the outstanding principal and interest is well-secured and, in the opinion of management, is deemed in the process of collection. When loans are placed on nonaccrual status, accrued but unpaid interest is reversed against the current year's income. The Bank of Hemet may treat payments on nonaccrual loans as interest income or return of principal depending upon management's opinion of the ultimate risk of loss on the individual loan. Cash payments are treated as interest income where management believes the remaining principal balance is fully collectible. Additionally, The Bank of Hemet may place loans not 90 days past due on nonaccrual status if management reasonably believes the borrower will not be able to comply with the contractual loan repayment terms and collection of principal or interest is in question.
- Accruing loans 90 days or more past due. The Bank of Hemet classifies a loan in this category when the borrower is more than 90 days late in making a payment of principal or interest but the loan has not been placed on nonaccrual status.

Nearly all nonperforming loans during the periods reported were secured by first deeds of trust on real property. The collateral securing these nonperforming loans at December 31, 1998 may not be sufficient to prevent losses on such loans.

OTHER REAL ESTATE OWNED ("OREO"). This category of nonperforming assets consists of real estate to which The Bank of Hemet has taken title by reason of foreclosure or by taking a deed in lieu of foreclosure from the borrower. The Bank of Hemet has been actively managing its OREO while attempting to expeditiously dispose of the properties. At December 31, 1998, the bank owned one OREO property, consisting of a single family residence valued at \$77,000. For a more complete discussion of changes in OREO during the last three years, please refer to "The Bank of Hemet Management's Discussion and Analysis of Results of Operations--Noninterest Expense."

The following table summarizes The Bank of Hemet's nonperforming assets at the dates indicated.

<TABLE>

<CAPTION>

	DECEMBER 31,				
	1998	1997	1996	1995	1994
	(DOLLARS IN THOUSANDS)				
<S>	<C>	<C>	<C>	<C>	<C>
Nonaccrual loans(1).....	\$ 1,578	\$ 2,902	\$ 2,976	\$ 2,446	\$ 3,188
Loans past due 90 days or more.....	3	--	17	14	--
Total nonperforming loans.....	1,581	2,902	2,993	2,460	3,188
Other real estate owned.....	77	779	2,180	3,908	2,719
Total nonperforming assets.....	\$ 1,658	\$ 3,681	\$ 5,173	\$ 6,368	\$ 5,907
Nonperforming loans as a percent of total loans.....	0.76%	1.51%	1.60%	1.32%	1.72%
Nonperforming assets as a percent of total assets.....	0.66%	1.53%	2.21%	2.79%	2.64%

</TABLE>

(1) Interest income in the amount of \$277,000 would have accrued during 1998 on loans on nonaccrual status if interest had been accrued. Income of \$115,000

was in fact recognized on nonaccrual loans in 1998 based on receipt of actual interest payments.

**IMPAIRED LOANS.** Management defines impaired loans, regardless of past due status on loans, as those on which principal and interest are not expected to be collected under the original contractual loan repayment terms. The Bank of Hemet charges off an impaired loan at the time management believes it has exhausted the collection process. The Bank of Hemet values impaired loans based on the present value of future cash flows discounted at the loan's effective rate, the loan's observable market price or the fair value of collateral if the loan is collateral-dependent. Impaired loans at December 31, 1998 were \$3.3 million, \$1.6 million of which were also nonaccrual loans. On account of these impaired loans, The Bank of Hemet had an allowance for loan and lease losses of \$287,000 at December 31, 1998. The average outstanding principal balance of impaired loans was \$4.0 million during 1998. Substantially all of the impaired loans at December 31, 1998 were collateral dependent and management measured them using the fair value of the collateral.

**SUBSTANDARD AND DOUBTFUL LOANS.** The Bank of Hemet classifies loans as "substandard" in accordance with regulatory requirements when they are inadequately protected by the current sound worth and paying capacity of the borrower or of the collateral for loan, if any. Substandard loans generally have a well-defined weaknesses that jeopardize repayment. They are characterized by the distinct possibility that the bank will sustain some loss if the deficiencies are not corrected.

The Bank of Hemet classifies loans as "doubtful," in accordance with regulatory requirements, when the loans have the inherent weaknesses of substandard loans and, in addition, the weaknesses make collection or repayment in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. However, in such loans, various important and reasonably specific pending factors may work to the advantage and strengthening of the asset. Accordingly, with respect to such loans, the estimated loss is deferred until its more exact status may be determined.

**RESTRUCTURED LOANS.** The Bank of Hemet considers restructured loans as loans on which interest accrues at a below market rate or on which a portion of the principal has been forgiven to help the borrower make final repayment of the loan. Any interest previously

56

accrued, but not yet collected, is reversed against current income when the loan is placed in this category. Interest is then reported on a cash basis until the borrower establishes an ability to service the restructured loans in accordance with its terms. The Bank of Hemet does not have any loans categorized as restructured loans.

Except as disclosed above, there were no assets as of December 31, 1998 where known information about possible credit problems of borrowers caused management to have serious doubts as to the ability of the borrower to comply with the present loan repayment terms. However, it is always possible that current credit problems may exist that may not have been discovered by management. Given the high percentage of The Bank of Hemet's loans that are secured by real estate, the real estate market in Southern California and the overall economy in The Bank of Hemet's market area are likely to continue to have a significant effect on the quality of The Bank of Hemet's assets in the future.

**ALLOWANCES AND PROVISIONS FOR LOAN AND LEASE LOSSES**

The following table sets forth an analysis of the allowance for loan and lease losses and provisions for loan and lease losses for the periods indicated.

<TABLE>  
<CAPTION>

	DECEMBER 31,				
	1998	1997	1996	1995	1994
	(DOLLARS IN THOUSANDS)				
<S>	<C>	<C>	<C>	<C>	<C>
Balance at beginning of period.....	\$ 2,116	\$ 2,241	\$ 2,135	\$ 2,609	\$ 2,520
Loans charged off:					
Real estate--construction.....	--	--	--	--	625
Real estate--mortgage.....	139	274	562	179	776
Commercial.....	--	159	272	348	43
Consumer.....	43	18	68	90	17
Total charge-offs.....	182	451	902	617	1,461
Recoveries:					
Real estate--construction.....	--	--	--	--	--
Real estate--mortgage.....	225	57	16	18	9
Commercial.....	47	10	2	--	35

Consumer.....	26	9	2	5	6
Total recoveries.....	298	76	20	23	50
Net charge-offs.....	(116)	375	882	594	1,411
Provision for possible loans losses.....	--	250	988	120	1,500
Balance at end of period.....	\$ 2,232	\$ 2,116	\$ 2,241	\$ 2,135	\$ 2,609
Average total loans outstanding(1).....	\$ 196,675	\$ 187,298	\$ 184,307	\$ 183,632	\$ 185,708
Total loans at end of period(1).....	207,802	192,287	187,441	185,717	185,746
Net charge-offs/average loans outstanding.....	(0.06)%	0.20%	0.48%	0.32%	0.76%
Allowance at end of period/loans outstanding.....	1.07%	1.10%	1.20%	1.15%	1.40%
Allowance/nonperforming loans.....	141.16%	72.90%	74.86%	86.78%	81.84%

(1) Net of deferred loan origination fees.

The Bank of Hemet maintains an allowance for loan and lease losses at a level considered by management to be adequate to cover the inherent risks of loss associated with its loan portfolio under prevailing and anticipated economic conditions. In determining the adequacy

57

of the allowance, management takes into consideration primarily the credit quality of the portfolio and prior loan loss experience. The specific calculation of the allowance for loan and lease losses is based on the risk rating system that The Bank of Hemet uses to grade its loans. This system classifies all loans into one of eight grades according to a risk-rating matrix that evaluates each of the five following factors:

- the dependability of the primary repayment source;
- the dependability of the secondary repayment source;
- the value of the collateral in relation to the size of the loan, and the liquidity of the collateral;
- the character/relationship of the borrower; and
- the strength, stability and potential of the industry in which the borrower is operating.

Different reserve percentages are assigned to each different class of loan, as summarized in the following table.

LOAN GRADE	RESERVE PERCENTAGE
Class I ("Pass").....	0.10%
Class II ("Pass").....	0.20%
Class III ("Pass").....	Historical loan loss experience factor
Class IV ("Watch").....	Calculated on a loan by loan basis
Class V ("Special Mention").....	Calculated on a loan by loan basis
Class VI ("Substandard").....	Calculated on a loan by loan basis
Class VII ("Doubtful").....	Minimum of 50.00%
Class VIII ("Loss").....	100.00%

Management assigns reserve percentages to the first two classes, reflecting management's judgment of the likelihood of loss in each risk category. For the third grade, in which most "pass loans" fall, management assigns a reserve percentage to each of the following kinds of loans: commercial loans, commercial real estate loans, residential real estate loans, construction loans and consumer loans. The reserve percentage represents the historical loss rate on this category of loans for the preceding 36 months. For the next three categories, management assigns specific reserves based on a risk analysis of each loan. The Bank of Hemet's board of directors approves the adequacy of the allowance for loan and lease losses on a quarterly basis.

The balance in the allowance is affected by amounts provided from operations, amounts charged-off and recoveries of previously charged-off loans. For 1998, The Bank of Hemet recorded no provision for loan and lease losses, compared with provisions of \$250,000 for 1997 and \$988,000 for 1996. The lack of a provision in 1998 resulted from management's determination, in accordance with the policy discussed above, that the allowance was adequate at December 31, 1998. In fact, the allowance had grown in 1998 by reason of net recoveries on

loans previously charged-off in the amount of \$116,000, compared with net charge-offs of \$375,000 in 1997 and \$882,000 in 1996. These trends reflected, among other factors, the strengthening of the Southern California economy. The decreased provision in 1997 as compared with 1996 reflected the significant decrease in net charge-offs during 1997 as compared

with 1996. The increased provision in 1996 mainly resulted from the decline in real estate collateral value for one borrower in that year.

At December 31, 1998 the allowance for loan and lease losses stood at \$2.2 million or 1.07% of total loans outstanding, compared with \$2.1 million or 1.10% of total loans outstanding at December 31, 1997, and \$2.2 million, or 1.20% of total loans outstanding at December 31, 1996.

Management anticipates the continued stabilization of the economy in segments of The Bank of Hemet's market area. However, underlying trends in the economic cycle will influence credit quality, particularly in Southern California. Management cannot completely predict these trends. Consequently, The Bank of Hemet may sustain loan losses, in any particular period, that are sizable in relation to the allowance for loan and lease losses. Additionally, a subsequent evaluation of the loan portfolio, in light of factors then prevailing, by The Bank of Hemet and its regulators may indicate a requirement for increases in the allowance for loan and lease losses through charges to the provision for loan and lease losses.

The following table summarizes a breakdown of the allowance for loan and lease losses by loan category and the allocation in each category as a percentage of total loans in each category at the dates indicated:

<TABLE>  
<CAPTION>

	DECEMBER 31,					
	1998		1997		1996	
	% OF LOANS IN		% OF LOANS IN		% OF LOANS IN	
	AMOUNT	CATEGORY	AMOUNT	CATEGORY	AMOUNT	CATEGORY
			(DOLLARS IN THOUSANDS)			
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Real estate--construction.....	\$ 3	0.1%	\$ 66	3.1%	\$ 83	3.7%
Real estate--mortgage.....	2,042	91.5	1,984	93.8	2,082	92.9
Commercial.....	171	7.7	47	2.2	56	2.5
Consumer loans.....	16	0.7	19	0.9	20	0.9
Total.....	\$ 2,232	100.0%	\$ 2,116	100.0%	\$ 2,241	100.0%

</TABLE>

Allocations of the loan and lease losses by category are not available in The Bank of Hemet's records for 1995 and 1994. However, real-estate mortgage loans constituted 87.8% of The Bank of Hemet's portfolio in 1995 and 88.3% in 1994. Accordingly, management believes that more than 90% of the allowance in 1995 and 1994 was allocable to real-estate mortgage loans as it was in 1998, 1997 and 1996.

The allocation of the allowance to loan and lease categories is an estimate by management of the relative risk characteristics of loans in those categories. Losses in one or more loan categories may exceed the portion of the allowance allocated to that category or even exceed the entire allowance. The Bank of Hemet did not make an allocation of loan loss reserves by loan category in 1995 or 1994.

DEPOSITS

Deposits are The Bank of Hemet's primary source of funds. At December 31, 1998, The Bank of Hemet had a deposit mix of 54.3% in time deposits, 29.4% in savings and interest-bearing checking accounts, 14.7% in noninterest-bearing demand accounts and 1.6% in money market accounts.

Noninterest-bearing demand deposits enhance The Bank of Hemet's net interest income by lowering its costs of funds. The Bank is committed to continuing its recent efforts to increase core deposits through increased business development efforts, diversification of its customer base, product line enhancements and superior customer service. Currently, deposits from the local market area are increasing, thus decreasing reliance on potentially unstable sources of funds.

The Bank of Hemet obtains deposits primarily from the communities it serves.



No material portion of its deposits has been obtained from or is dependent on any one person or industry. The Bank of Hemet's business is not seasonal in nature. The Bank of Hemet accepts deposits in excess of \$100,000 from customers. These deposits are priced to remain competitive. At December 31, 1998, The Bank of Hemet had no brokered deposits.

The following table sets forth the average balances and the average rates paid for the major categories of deposits for the dates indicated:

<TABLE>  
<CAPTION>

	DECEMBER 31,					
	1998		1997		1996	
	AVERAGE BALANCE	AVERAGE RATE PAID	AVERAGE BALANCE	AVERAGE RATE PAID	AVERAGE BALANCE	AVERAGE RATE PAID
	(DOLLARS IN THOUSANDS)					
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Noninterest-bearing demand.....	\$ 33,349	--%	\$ 29,831	--%	\$ 25,981	--%
Interest-bearing demand.....	14,204	1.07	13,722	1.10	14,837	1.13
Money market deposits.....	3,970	2.72	4,660	2.75	5,393	2.82
Savings deposits.....	48,793	4.01	47,468	4.11	41,968	4.07
Time deposits of \$100,000 or more.....	9,036	5.54	8,662	5.65	15,537	5.73
Time deposits under \$100,000.....	116,876	5.53	109,948	5.65	106,222	5.56
Total average deposits.....	\$ 226,228	4.06	\$ 214,291	4.17	\$ 209,938	4.20

</TABLE>

MATURITIES OF TIME CERTIFICATES OF DEPOSIT

Maturities of time certificates of deposits outstanding at December 31, 1998 are summarized as follows:

<TABLE>  
<CAPTION>

	\$100,000 OR MORE	LESS THAN \$100,000
	(IN THOUSANDS)	
<S>	<C>	<C>
Three months or less.....	\$ 2,642	\$ 29,684
Over three to six months.....	1,649	26,310
Over six to twelve months.....	2,976	53,833
Over twelve months.....	874	7,053
Total.....	\$ 8,141	\$ 116,880

</TABLE>

DATA PROCESSING SERVICES--BANKLINK CORPORATION

BankLink Corporation, a wholly owned subsidiary of The Bank of Hemet located in Riverside, California, provides data processing services and item processing services to The Bank of Hemet and other financial institutions. BankLink Corporation serves eight client banks as of December 31, 1998. BankLink Corporation uses Information Technology Incorporated application software systems to provide high volume processing capabilities and systems support services for deposit and loan transactions, treasury functions and loan servicing. These services encompass all of the normal banking applications, including accounts payable, fixed assets, ACH origination, automated exception processing, asset/liability management, corporate cash management, telephone banking, and account analysis.

For the year ended December 31, 1998, BankLink Corporation had revenues from its operations of \$1.1 million.

SUPERVISION AND REGULATION

As a California licensed bank, insured by the Federal Deposit Insurance Corporation, The Bank of Hemet is subject to many governmental rules that affect its operations. For a description of the laws and regulations that apply to The Bank of Hemet, please refer to the section entitled "Supervision and Regulation," starting on page 114.

COMPETITION

The Bank of Hemet considers its primary service area to include Riverside and San Bernardino counties of California. The banking business is highly competitive in California, including this region. A number of major banks and savings and loans associations have offices in this area. They currently dominate loan and deposit origination. The Bank of Hemet also competes for deposits and loans with finance companies, industrial loan companies, securities and brokerage companies, mortgage companies, insurance companies, money market funds, credit unions and other financial institutions.

Major banks and savings and loans associations exercise certain competitive advantages over community banks like The Bank of Hemet. They can finance extensive advertising campaigns and offer the convenience of many retail outlets. Many offer services, such as trust and international banking services, which The Bank of Hemet does not offer directly. They can invest greater resources in technology, which may afford them economies of scale, particularly with respect to consumer financial services, by reason of their larger customer bases. In addition, these larger institutions likely have lower costs of capital and substantially higher lending limits.

To compete with larger financial institutions, The Bank of Hemet relies upon responsive handling of customer needs, local promotional activity, and personal contacts by its officers, directors and staff. For customers whose loan demands exceed The Bank of Hemet's lending limits, The Bank of Hemet seeks to arrange funding on a participation basis with its correspondent banks or other independent commercial banks. The Bank of Hemet also assists customers requiring services not offered by it to obtain such services from its correspondent banks.

In commercial real estate lending, The Bank of Hemet competes against larger institutions. Management seeks to assert its competitive advantage in this market through its depth

61

of experience and ability to respond in customized ways to the needs of its customers. In its deposit gathering, The Bank of Hemet competes by having convenient branches located in areas of high bank deposits per person, and by providing consumer-friendly environments at those branches.

#### EMPLOYEES

At December 31, 1998, The Bank of Hemet employed a total of 86 full-time equivalent employees, including four executive officers. None is presently represented by a union or covered by a collective bargaining agreement. The Bank of Hemet believes its employee relations are excellent.

#### LITIGATION

In April 1997, litigation relating to the acquisition of Inland Savings and Loan in 1992 by The Bank of Hemet was filed against The Bank of Hemet and certain of its directors. The legal action alleges improper adjustments to the value of the preferred stock of The Bank of Hemet issued to Inland Savings and Loan shareholders in connection with the 1992 acquisition. The named plaintiffs have sued on behalf of a class consisting of former owners of preferred stock of The Bank of Hemet. The action alleges breach of contract and breach of fiduciary duty and seeks compensatory damages in excess of \$2 million, together with punitive damages. In 1998, the court granted The Bank of Hemet's motion to remove the fraud cause of action. On January 14, 1999, the court certified the case as a class action. The court has dismissed allegations of fraud that were the primary basis for punitive damages, although fiduciary claims could still be the basis for punitive damages. The bank intends to vigorously defend against these claims, and has filed a motion for summary judgment on the breach of fiduciary duty claim. Any potential losses to The Bank of Hemet as a result of this action are not reasonably estimable, and accordingly no reserve for loss has been established in The Bank of Hemet's consolidated financial statements. Any losses which might be suffered by The Bank of Hemet related to this proceeding could impact The Bank of Hemet's future profitability.

From time to time, The Bank of Hemet is involved in other litigation as an incident to its business. In the opinion of management, no such other pending or threatened litigation is likely to have a material adverse effect on The Bank of Hemet's financial condition or results of operations.

#### INSURANCE

The Bank of Hemet maintains financial institution bond and commercial insurance at levels deemed adequate by The Bank of Hemet's management to protect it from some types of damage.

62

#### VALLEY BANK SELECTED FINANCIAL DATA

Set forth below is the selected financial data and operating data of Valley Bank for the periods indicated, which have been derived from Valley Bank's

audited financial statements. The selected financial data set forth below should be read in conjunction with Valley Bank's financial statements included elsewhere in this prospectus and "Valley Bank Management's Discussion and Analysis of Financial Condition and Results of Operations."

<TABLE>  
<CAPTION>

	AT OR FOR THE THREE MONTHS ENDED MARCH 31,		AT OR FOR THE YEAR ENDED DECEMBER 31,				
	1999	1998	1998	1997	1996	1995	1994
	(UNAUDITED)		(DOLLARS IN THOUSANDS EXCEPT PER SHARE INFORMATION)				
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
<b>RESULTS OF OPERATIONS</b>							
Interest income.....	\$ 1,422	\$ 1,559	\$ 6,181	\$ 5,978	\$ 5,338	\$ 4,954	\$ 4,237
Interest expense.....	366	342	1,438	1,282	1,119	1,007	857
Net interest income.....	1,056	1,217	4,743	4,696	4,219	3,947	3,380
Provision for loan and lease losses.....	90	150	200	980	360	610	160
Noninterest income.....	712	459	2,915	2,719	2,135	2,170	1,895
Noninterest expense.....	1,452	1,553	6,085	5,637	5,211	4,902	4,484
Provision for income taxes.....	95	(18)	584	242	329	199	210
Net income (loss).....	131	(9)	789	556	454	406	421
<b>BALANCE SHEET (END OF PERIOD)</b>							
Total assets.....	\$ 87,499	\$ 79,187	\$ 84,709	\$ 74,566	\$ 71,070	\$ 65,989	\$ 64,868
Total loans.....	41,734	48,688	43,149	45,260	42,999	34,292	32,882
Allowance for loan and lease losses.....	1,115	1,152	1,118	1,058	756	497	574
Nonperforming loans.....	4,600	2,637	5,083	3,227	1,245	1,235	3,173
Other real estate owned.....	1,611	1,632	1,749	1,711	1,144	2,555	1,143
Total deposits.....	78,430	70,978	75,739	66,239	63,286	59,001	58,334
Shareholders' equity.....	8,439	7,308	8,254	7,292	6,902	6,762	6,356
<b>BALANCE SHEET (PERIOD AVERAGE)</b>							
Total assets.....	\$ 86,742	\$ 77,487	\$ 81,248	\$ 74,409	\$ 69,940	\$ 66,525	\$ 65,101
Total loans.....	43,603	46,136	48,512	43,921	41,649	34,552	28,678
Earning assets.....	75,647	67,531	70,839	64,794	61,116	55,776	54,013
Total deposits.....	77,577	69,184	72,434	66,267	62,517	59,496	58,275
Shareholders' equity.....	8,666	7,277	7,716	6,972	6,796	6,505	5,182
<b>CAPITAL RATIOS</b>							
Leverage ratio.....	9.73%	9.43 %	10.20%	9.80%	9.70%	10.20%	9.80%
Tier 1 risk-based capital.....	15.09	12.84	15.50	13.50	13.90	14.50	15.80
Total risk-based capital.....	16.35	13.94	16.70	14.50	14.90	15.70	17.00
<b>ASSET QUALITY RATIOS</b>							
Nonperforming loans/total loans(1).....	11.02%	5.42 %	11.78%	7.13%	2.90%	3.60%	9.65%
Nonperforming assets/total assets(2).....	7.10	5.39	8.07	6.62	3.36	5.74	6.65
Allowance for loan losses/ nonperforming loans.....	24.24	43.69	21.99	32.79	60.72	40.24	18.09
Allowance for loan losses/total loans.....	2.67	2.37	2.59	2.34	1.76	1.45	1.75

63

<TABLE>  
<CAPTION>

	AT OR FOR THE THREE MONTHS ENDED MARCH 31,		AT OR FOR THE YEAR ENDED DECEMBER 31,				
	1999	1998	1998	1997	1996	1995	1994
	(UNAUDITED)		(DOLLARS IN THOUSANDS EXCEPT PER SHARE INFORMATION)				
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
<b>PERFORMANCE RATIOS</b>							
Return on average assets(10).....	0.60%	(0.05) %	0.97%	0.75%	0.65%	0.61%	0.65%
Return on average equity(10).....	6.05	(0.49)	10.23	7.97	6.68	6.24	8.12
Net interest margin(3).....	5.58	6.74	6.77	7.28	6.96	6.89	6.26
Net interest spread(4).....	5.04	7.29	6.12	6.63	6.38	6.39	5.90
Average loans to average deposits.....	56.21	66.69	66.97	66.28	66.62	58.07	49.21
Efficiency ratio(5).....	82.13	92.66	79.46	76.02	82.01	80.14	85.00
<b>PER SHARE INFORMATION</b>							
Basic earnings(6).....	\$ 0.12	\$ (0.01)	\$ 0.73	\$ 0.53	\$ 0.41	\$ 0.35	\$ 0.36
Diluted earnings(7).....	\$ 0.12	\$ (0.01)	\$ 0.65	\$ 0.51	\$ 0.41	\$ 0.34	\$ 0.36
Dividends declared.....	\$ --	\$ --	\$ --	\$ --	\$ --	\$ --	\$ --
Dividend payout ratio(8).....	--%	-- %	--%	--%	--%	--%	--%
Book value.....	\$ 7.20	\$ 6.24	\$ 7.04	\$ 6.22	\$ 5.93	\$ 5.81	\$ 5.46
Shares outstanding at period end(9).....	1,171,906	1,171,906	1,171,906	1,171,906	1,164,034	1,164,034	1,164,034
Weighted average shares outstanding(9)....	1,089,588	1,084,112	1,084,112	1,055,293	1,094,211	1,164,034	1,164,034

- (1) Nonperforming loans consist of loans on nonaccrual, loans past due 90 days or more and restructured loans.
- (2) Nonperforming assets consist of nonperforming loans and other real estate owned.
- (3) Net interest margin is net interest income expressed as a percentage of average total interest-earning assets.
- (4) Net interest spread is the difference between the yield on average total interest-earning assets and cost of average total interest-bearing liabilities.
- (5) The efficiency ratio is the ratio of noninterest expense to the sum of net interest income before provision for loan losses and total noninterest income.
- (6) Basic earnings per share is computed by dividing net income by the weighted average number of shares outstanding during the period.
- (7) Diluted earnings per share reflects the potential dilution that would occur if securities or other contracts to issue common stock were exercised or converted into the common stock or resulted in the issuance of common stock that then shared in earnings.
- (8) The dividend payout ratio consists of the dividends paid per share divided by basic earnings per share.
- (9) Shares outstanding at period end include unearned ESOP shares and exclude shares issuable upon exercise of outstanding options. Weighted average shares outstanding, used to calculate earnings per share, do not include unearned ESOP shares.
- (10) Annualized for March 31, 1999 and 1998.

64

VALLEY BANK  
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION  
AND RESULTS OF OPERATIONS

THE FOLLOWING MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS CONTAINS FORWARD-LOOKING STATEMENTS THAT INVOLVE RISKS AND UNCERTAINTIES. VALLEY BANK'S ACTUAL RESULTS COULD DIFFER MATERIALLY FROM THOSE ANTICIPATED IN THESE FORWARD-LOOKING STATEMENTS AS A RESULT OF FACTORS DESCRIBED IN THE SECTION ENTITLED "RISK FACTORS" AND ELSEWHERE IN THIS PROSPECTUS.

The following discussion and analysis is designed to provide a better understanding of the significant changes and trends related to Valley Bank's financial condition, operating results, asset and liability management, liquidity and capital resources. The following discussion should be read in conjunction with the financial statements of Valley Bank.

FINANCIAL CONDITION

Total assets at March 31, 1999 were \$87.5 million compared to \$84.7 million at December 31, 1998, up approximately 3.3%. The increase is primarily attributable to a \$8.5 million increase in securities and a \$4.9 million decrease in federal funds sold. Total deposits increased 2.7% from \$75.7 million at December 31, 1998 to \$78.4 at March 31, 1999. Stockholders' equity was \$8.4 million at March 31, 1999, up from its \$8.3 level at year end.

Total assets at December 31, 1998 were \$84.7 million compared to \$74.6 million at December 31, 1997, up approximately 13.6%. This increase is attributable to an \$9.0 million increase in federal funds sold, a \$1.7 million increase in securities, a \$998,000 increase in cash due from banks, and a \$382,000 increase in other assets, offset by a \$2.8 million decrease in net loans. Total deposits increased from \$66.2 million as of December 31, 1997 to \$75.7 million as of December 31, 1998. Stockholders' equity was \$8.3 million at December 31, 1998, up from its \$7.3 million level a year earlier, owing primarily to net income of \$789,000 and a decrease in the amount of unearned Employee Stock Ownership Plan shares of \$108,000.

Valley Bank's loan portfolio, including loans held for sale of \$594,000, decreased by approximately \$2.2 million during the fiscal year ended December 31, 1998. For the time period December 31, 1998 to March 31, 1999, loans decreased \$103,000 while loans held for sale decreased \$194,000. The largest components of this decrease were in residential lending, which decreased \$2.3 million from \$7.1 million in 1997 to \$4.8 million in 1998, and loans secured by unimproved residential lots, which decreased \$1.5 million from \$6.4 million in 1997 to \$4.9 million in 1998. These decreases were partially offset by increases of \$907,000 and \$796,000 in commercial and industrial loans and government guaranteed loans, respectively. The loan portfolio decrease was also

attributable to an increase in the sale of government guaranteed loans, from \$12.1 million in 1997 to \$14.6 million in 1998. As the economy in Southern California continues to improve, there is a greater demand for both business and construction lending, thus allowing the bank the opportunity to originate loans to finance these demands. Loan demand in the Pacific Northwest has remained strong and steady during the past two years. Valley Bank expects loan demand in its market areas to remain strong. Because Valley Bank expects to continue to sell government guaranteed loans in the secondary market, strong loan originations will not necessarily result in increases in the size of its loan portfolio.

ANALYSIS OF FINANCIAL CONDITION

The following table sets forth the average balances of each principal category of Valley Bank's assets, liabilities and capital accounts for the periods indicated, as well as the percentage of each category to total assets for the periods indicated. Average balances used throughout this prospectus are based on daily averages.

<TABLE>  
<CAPTION>

	FOR THE YEAR ENDED DECEMBER 31,					
	1998		1997		1996	
	AVERAGE BALANCE	PERCENT OF TOTAL ASSETS	AVERAGE BALANCE	PERCENT OF TOTAL ASSETS	AVERAGE BALANCE	PERCENT OF TOTAL ASSETS
	(DOLLARS IN THOUSANDS)					
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Assets:						
Cash and due from banks.....	\$ 5,883	7.2%	\$ 5,584	7.5%	\$ 5,076	7.3%
Federal funds sold.....	8,631	10.6	6,506	8.7	5,060	7.2
Investment securities--taxable.....	12,022	14.8	12,246	16.5	11,804	16.9
Investment securities--non-taxable.....	987	1.2	1,474	2.0	1,976	2.8
Loans, net of allowance for loan losses and net of deferred loan fees and unearned income.....	47,436	58.4	42,925	57.7	40,996	58.6
Premises and equipment.....	2,185	2.7	2,184	2.9	2,280	3.3
Other assets.....	4,104	5.1	3,490	4.7	2,748	3.9
Total assets.....	\$ 81,248	100.0%	\$ 74,409	100.0%	\$ 69,940	100.0%
Liabilities and shareholders' equity:						
Deposits:						
Demand.....	\$ 19,212	23.7%	\$ 18,098	24.3%	\$ 16,502	23.6%
Savings and interest-bearing demand.....	38,063	46.8	35,773	48.1	35,553	50.8
Time deposits of \$100,000 or more.....	2,909	3.6	1,761	2.4	1,625	2.3
Time deposits under \$100,000.....	12,250	15.1	10,635	14.3	8,837	12.7
Total deposits.....	72,434	89.2	66,267	89.1	62,517	89.4
Accrued interest payable and other liabilities.....	1,098	1.3	1,170	1.6	627	0.9
Total liabilities.....	73,532	90.5	67,437	90.7	63,144	90.3
Common stock.....	5,860	7.2	5,761	7.7	5,544	7.9
Retained earnings.....	1,856	2.3	1,211	1.6	1,252	1.8
Total shareholders' equity.....	7,716	9.5	6,972	9.3	6,796	9.7
Total liabilities and shareholders' equity.....	\$ 81,248	100.0%	\$ 74,409	100.0%	\$ 69,940	100.0%

</TABLE>

RESULTS OF OPERATIONS

OVERVIEW.

MARCH 31, 1999 AS COMPARED TO MARCH 31, 1998

For the three months ended March 31, 1999, Valley Bank reported net income of \$131,000 compared to a net loss of (\$9,000) for the same period in 1998. Basic earnings (loss) per share were \$.12 for the three months ended March 31, 1999 as compared to \$(.01) for the same period in 1998. The return on average assets on an annualized basis was .60% for the three months ended March 31, 1999 as compared to (.05)% in 1998. Valley Bank's return on average equity on an annualized basis was 6.05% for 1999 and (.49)% for 1998. Factors that significantly affected net income (loss) for the three months ended March 31, 1999 as compared to March 31, 1998 included reduction in net interest income of \$161,000, an increase in the provision for loan losses of \$60,000, an increase in other expenses of \$101,000, and an increase in gain on sale of loans of

DECEMBER 31, 1998 AS COMPARED TO DECEMBER 31, 1997

Net income for 1998 was \$789,000 compared with \$556,000 in 1997 and \$454,000 in 1996. Basic earnings per share were \$0.73 in 1998 compared with \$0.53 in 1997 and \$0.41 in 1996. The return on average assets was 0.97% in 1998 compared with 0.75% in 1997 and 0.65% in 1996. Valley Bank's return on average equity was 10.23% for 1998, 7.97% for 1997 and 6.68% for 1996. Factors that significantly affected net income for 1998 as compared to 1997 included a reduction of \$780,000 in the provision for loan and lease loss reserves, a gain on the sale of loans of \$285,000, an increase in legal and professional expenses of \$334,000 and a significant recovery that offset OREO expenses for the year.

NET INTEREST INCOME. Total interest and fee income on earning assets decreased to \$1.4 million from \$1.6 million or 12.5% for the three months ended March 31, 1999 compared to March 31, 1998. Net interest income decreased to \$1.1 million from \$1.2 million for the three months ended March 31, 1999 from March 31, 1998. Average interest-earning assets at March 31, 1999 were \$75.6 million compared with \$67.5 million at March 31, 1998, an increase of \$8.1 million or 12%. The 1999 decrease in interest income was primarily the result of both a decrease in loans and a decrease in interest rates from March 31, 1998.

Total interest and fee income on earning assets increased to \$6.2 million from \$6.0 million, or 3.4%, in 1998 compared with 1997. Net interest income increased to \$4.8 million from \$4.7 million, or 1.0%, in 1998 from 1997. Average interest-earning assets in 1998 were \$70.8 million compared with \$64.8 million in 1997, an increase of \$6.0 million or 9.3%. The 1998 increase in interest income was primarily the result of the growth in interest-earning assets. The 1997 increase in interest income was also attributable to growth in interest-earning assets.

Total average interest-bearing liabilities at March 31, 1999 were \$57.6 million compared with \$53.7 million at December 31, 1998, an increase of \$3.9 million, or 7.3%. This amount reflects an increase of \$2.3 million or 6% in lower cost deposit accounts. Total interest expense increased from \$342,000 to \$366,000, or 7.0%, for the three months ended March 31, 1999 compared to March 31, 1998. This was due to an increase in interest-bearing deposits.

Total average interest-bearing liabilities in 1998 were \$53.7 million compared with \$48.7 million in 1997, an increase of \$5.0 million, or 10.3%. This amount reflects a significant increase in lower cost deposit accounts, primarily NOW accounts, as a result of consolidation in the local banking market. Total interest expense increased from \$1.3 million to \$1.4 million, or 12.2%, in 1998 compared with 1997 and increased from \$1.1 million to \$1.3 million, or 14.6% in 1997 compared with 1996. This was largely the result of the 10.3% increase in 1998 and 5.2% increase in 1997 in the amount of interest-bearing liabilities.

Valley Bank's net interest margin, on an annualized basis, was 5.58% for the three months ended March 31, 1999, compared to 6.74% in the first three months of 1998. The reduction in the net interest margin in the first three months of 1999, as compared to the first three months of 1998, was the direct result of the prime rate and federal funds rate reductions experienced during the latter months of 1998.

Valley Bank's net interest margin was 6.77% for 1998, compared with 7.28% for 1997 and 6.96% for 1996. The reduction in net interest margin in 1998, as compared with 1997, was a direct result of the prime rate and federal funds rate reductions experienced in 1998. These rate reductions affected the rates received on Valley Bank's loan portfolio and other assets more than they affected the interest paid by it on deposits and other liabilities. Despite

reduction in its net interest margin, Valley Bank's overall net interest income increased, primarily as a result of an increase in its volume of earning assets. The increase in net interest margin in 1997, as compared with 1996, was the direct result of the increase in the amount of loans outstanding.

AVERAGE BALANCES AND RATES EARNED AND PAID. The following table presents, for the periods indicated, average balance sheet information for Valley Bank, together with interest rates earned and paid on the various sources and uses of its funds. The table is arranged to group the elements of interest-earning assets and interest-bearing liabilities, these items being the major sources of income and expense. Nonaccruing loans are included in the calculation of average loan balances, but the nonaccrued interest thereon is excluded.

<TABLE>  
<CAPTION>

YEAR ENDED DECEMBER 31,

-----

	1998			1997			1996
	AVERAGE BALANCE	INCOME/ EXPENSE	RATES EARNED/ PAID	AVERAGE BALANCE	INCOME/ EXPENSE	RATES EARNED/ PAID	AVERAGE BALANCE
(DOLLARS IN THOUSANDS)							
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
<b>ASSETS</b>							
Investments(1):							
Federal funds sold.....	\$ 8,631	\$ 444	5.14%	\$ 6,506	\$ 354	5.44%	\$ 5,060
Securities, taxable.....	12,022	724	6.02%	12,246	764	6.24%	11,804
Securities, nontaxable.....	987	54	5.47%	1,474	76	5.16%	1,976
Total investments.....	\$ 21,640	\$ 1,222	5.65%	\$ 20,226	\$ 1,194	5.90%	\$ 18,840
Loans(2):							
Commercial.....	3,892	339	8.71%	2,273	220	9.68%	2,051
Real estate.....	44,174	4,567	10.34%	41,199	4,511	10.95%	39,203
Installment.....	446	53	11.88%	449	53	11.80%	395
Total loans.....	\$ 48,512	\$ 4,959	10.22%	\$ 43,921	\$ 4,784	10.89%	\$ 41,649
Cash value of life insurance.....	687	52	7.57%	647	23	3.55%	627
Total earning assets.....	\$ 70,839	\$ 6,233	8.80%	\$ 64,794	\$ 6,001	9.26%	\$ 61,116
Non earning assets:							
Allowance for loan and lease losses...	(1,076)			(996)			(653)
Cash and due from banks.....	5,883			5,584			5,076
Premises and equipment.....	2,185			2,184			2,280
Interest receivable and other assets.....	3,417			2,843			2,121
Total assets.....	\$ 81,248			\$ 74,409			\$ 69,940
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>							
Interest bearing deposits:							
NOW.....	19,297	200	1.04%	17,373	180	1.04%	16,652
Savings.....	11,505	229	1.99%	11,220	223	1.99%	11,080
Money market.....	7,261	181	2.49%	7,180	176	2.45%	7,821
Certificates of deposit under \$100,000.....	12,250	629	5.13%	10,635	534	5.02%	8,837
Certificates of deposit of \$100,000 or more.....	2,909	148	5.09%	1,761	114	6.47%	1,625
Total interest bearing deposits.....	53,222	1,387	2.61%	48,169	1,227	2.55%	46,015
Other borrowings.....	527	51	9.68%	561	55	9.80%	327
Total interest bearing liabilities.....	53,749	\$ 1,438	2.68%	48,730	\$ 1,282	2.63%	46,342
Non-interest bearing deposits.....	19,212			18,098			16,502
Other liabilities.....	571			609			300
Stockholders' equity.....	7,716			6,972			6,796
Total liabilities and stockholders' equity.....	\$ 81,248			\$ 74,709			\$ 69,940
Net interest income.....		\$ 4,795			\$ 4,719		
Net interest spread(3).....			6.12%			6.63%	
Net interest margin(4).....			6.77%			7.28%	

<CAPTION>

	INCOME/ EXPENSE	RATES EARNED/ PAID
<S>	<C>	<C>
<b>ASSETS</b>		
Investments(1):		
Federal funds sold.....	\$ 269	5.32%
Securities, taxable.....	703	5.96%
Securities, nontaxable.....	100	5.06%
Total investments.....	\$ 1,072	5.69%
Loans(2):		
Commercial.....	216	10.53%
Real estate.....	4,004	10.21%
Installment.....	46	11.65%

Total loans.....	\$ 4,266	10.24%
Cash value of life insurance.....	33	5.26%
-----		
Total earning assets.....	\$ 5,371	8.79%
-----		
Non earning assets:		
Allowance for loan and lease losses...		
Cash and due from banks.....		
Premises and equipment.....		
Interest receivable and other assets.....		
Total assets.....		
LIABILITIES AND STOCKHOLDERS' EQUITY		
Interest bearing deposits:		
NOW.....	173	1.04%
Savings.....	227	2.05%
Money market.....	192	2.45%
Certificates of deposit under \$100,000.....	425	4.81%
Certificates of deposit of \$100,000 or more.....	92	5.66%
-----		
Total interest bearing deposits...	1,109	2.41%
Other borrowings.....	10	3.06%
-----		
Total interest bearing liabilities.....	\$ 1,119	2.41%
-----		
Non-interest bearing deposits.....		
Other liabilities.....		
Stockholders' equity.....		
Total liabilities and stockholders' equity.....		
Net interest income.....	\$ 4,252	
Net interest spread(3).....		6.38%
Net interest margin(4).....		6.96%

(FOOTNOTES ON NEXT PAGE)

68

- (1) The yield for securities reflects that Valley Bank's entire investment portfolio is classified as held-to-maturity and is based on historical amortized cost balances. Municipal securities are not reported on a tax-exempt equivalent basis.
- (2) Loans, net of unearned income, include nonaccrual loans but do not reflect average reserves for possible loan losses. Loan fees of \$307,000 in 1998, \$417,000 in 1997 and \$229,000 in 1996 are included in loan interest income. There were non-accruing loans totaling approximately \$4,827,000 at December 31, 1998, \$3,227,000 at December 31, 1997, and \$1,245,000 at December 31, 1996.
- (3) Net interest spread is the difference between the yield on average total interest-earning assets and cost of average total interest-bearing liabilities.
- (4) Net interest margin is net interest income expressed as a percentage of average total interest-earning assets.

69

NET INTEREST INCOME CHANGES DUE TO VOLUME AND RATE. The following table sets forth, for the periods indicated, a summary of the changes in average asset and liability balances and interest earned and interest paid resulting from changes in average asset and liability balances, or volume, and changes in average interest rates. The changes in interest due to both rate and volume have been allocated to the change in average rate. Nonaccruing loans are included in the table for computational purposes, but the nonaccrued interest thereon is excluded.

<TABLE>		
<CAPTION>		
	1998 COMPARED WITH 1997	1997 COMPARED WITH 1996
	-----	-----
	INCREASE (DECREASE)	INCREASE (DECREASE)
	DUE TO CHANGE IN	DUE TO CHANGE IN



	AVERAGE VOLUME	AVERAGE RATE	TOTAL	AVERAGE VOLUME	AVERAGE RATE
(IN THOUSANDS) (UNAUDITED)					
<S>	<C>	<C>	<C>	<C>	<C>
INCREASE (DECREASE) IN INTEREST AND FEE INCOME					
Investment securities:					
Federal funds sold.....	\$ 116	\$ (26)	\$ 90	\$ 77	\$ 8
U.S. Treasury & U.S. government agency securities.....	(14)	(26)	(40)	26	35
State and political subdivisions.....	(25)	3	(22)	(25)	1
Total investment securities.....	\$ 77	\$ (49)	\$ 28	\$ 78	\$ 44
Loans:					
Commercial.....	157	(38)	119	24	(20)
Real estate.....	326	(270)	56	204	303
Installment.....	0	0	0	6	1
Total loans.....	483	(308)	175	234	284
Cash surrender value of life insurance.....	1	28	29	1	(11)
Total earning assets.....	\$ 561	\$ (329)	\$ 232	\$ 313	\$ 317
INCREASE (DECREASE) IN INTEREST EXPENSE					
Interest bearing deposits:					
NOW.....	\$ 20	\$ 0	\$ 20	\$ 7	\$ (0)
Savings.....	6	0	6	3	(7)
Money market.....	2	3	5	(16)	(0)
Certificates of deposit under \$100,000.....	81	14	95	86	23
Certificates of deposit of \$100,000 or more.....	74	(40)	34	8	14
Total interest bearing deposits.....	183	(23)	160	88	30
Other borrowings.....	(3)	(1)	(4)	7	38
Total interest bearing liabilities.....	180	(24)	156	95	68
TOTAL CHANGE IN NET INTEREST INCOME.....	\$ 381	\$ (305)	\$ 76	\$ 218	\$ 249

<CAPTION>

	TOTAL
<S>	<C>
INCREASE (DECREASE) IN INTEREST AND FEE INCOME	
Investment securities:	
Federal funds sold.....	\$ 85
U.S. Treasury & U.S. government agency securities.....	61
State and political subdivisions.....	(24)
Total investment securities.....	\$ 122
Loans:	
Commercial.....	4
Real estate.....	507
Installment.....	7
Total loans.....	518
Cash surrender value of life insurance.....	(10)
Total earning assets.....	\$ 630
INCREASE (DECREASE) IN INTEREST EXPENSE	
Interest bearing deposits:	
NOW.....	\$ 7
Savings.....	(4)
Money market.....	(16)
Certificates of deposit under \$100,000.....	109
Certificates of deposit of \$100,000 or more.....	22
Total interest bearing deposits.....	118
Other borrowings.....	45
Total interest bearing liabilities.....	163
TOTAL CHANGE IN NET INTEREST INCOME.....	\$ 467

## PROVISIONS FOR LOAN AND LEASE LOSSES.

For the three months ended March 31, 1999, Valley Bank recorded a provision for loan losses of \$90,000 compared with a provision of \$150,000 for the same period in 1998. For the three months ended March 31, 1999 net loans charged off totaled \$93,000 compared with net charge offs of \$56,000 for the like period of 1998. For the year ended December 31, 1998, Valley Bank recorded a provision for loan and lease losses of \$200,000 compared with provisions of \$980,000 for 1997 and \$360,000 for 1996. In 1998 net charge offs totaled \$140,000 compared with net charge offs of \$678,000 for 1997 and \$101,000 in 1996. The decreased

70

provision in 1998 was the direct result of a large recovery received on a loan, which had been charged off in a prior year. The increased provision in 1997 was a result of an increased provision mandated by banking regulators relating to loans secured by unimproved real property in Fort Mohave, Arizona.

## NONINTEREST INCOME.

Noninterest income for the three months ended March 31, 1999 increased to \$712,000 from \$459,000 for the three months ended March 31, 1998, an increase of \$253,000, or 55.1%. The increase for 1999 resulted primarily from the gain on sale of government guaranteed loans of \$220,000. Noninterest income in 1998 increased to \$2.9 million from \$2.7 million in 1997, an increase of \$196,000 or 7.2%. The increase for 1998 resulted primarily from the increase in the gain from sale of government guaranteed loans of \$285,000, offset by a decrease in service charges and other fees of \$144,000. Noninterest income in 1997 increased to \$2.7 million from \$2.1 million in 1996, an increase of \$584,000 or 27.4%. The increase for 1997 is attributable primarily to the increase in gain on the sale of government guaranteed loans of \$397,000 and the increase in service charges of \$201,000.

## NONINTEREST EXPENSE.

Noninterest expense for the three months ended March 31, 1999 decreased to \$1.5 million from \$1.6 million for the three months ended March 31, 1998, a decrease of \$101,000 or 6.5%. Noninterest expense in 1998 was \$6.1 million, an increase of \$448,000, or 7.9%, compared with 1997. Noninterest expense in 1997 was \$5.6 million, an increase of \$426,000, or 8.2%, compared with noninterest expense of \$5.2 million in 1996. The principal component of noninterest expense was salaries and employee benefits, which increased to \$3.3 million in 1998, from \$3.0 million in 1997 and \$2.6 million in 1996. Legal and professional fees increased \$334,000 in 1998 with a portion of that increase being attributable to the merger with Pacific Community Banking Group. Expenses for other real estate owned decreased from \$294,000 in 1997 to \$41,000 in 1998 partially due to the receipt of reimbursements for other real estate owned expenses. Other expenses increased from \$5.2 million in 1996 to \$5.6 million in 1997 or 8.2%. This increase is due to an increase in salaries and employee benefits which was partially due to the opening of a new loan production office in Oregon, as well as other normal salary increases. In addition, other real estate owned expenses decreased from \$401,000 in 1996 to \$294,000 in 1997.

## PROVISION FOR INCOME TAXES.

Valley Bank's provision for income taxes was \$95,000 for the three months ended March 31, 1999 compared to a tax benefit of \$(18,000) for the three months ended March 31, 1998. Valley Bank's provision for income taxes was \$584,000 in 1998, \$242,000 in 1997 and \$329,000 in 1996. The effective income tax rate was 42.5% in 1998 compared with 30.3% in 1997 and 42.0% in 1996. In 1997, the decrease in effective income tax rate was primarily due to a decrease in the valuation allowance for deferred taxes of \$134,000. The valuation allowance was reduced because management believes it is more likely than not that deferred tax assets will be realized.

71

## NET INCOME.

Net income for the three months ended March 31, 1999 was \$131,000 compared to a loss of \$(9,000) for the same period prior year. Basic earnings (loss) per share for the three months ended March 31, 1999 and March 31, 1998 were \$0.12 and \$(0.01), respectively. The return on average assets on an annualized basis for the three months ended March 31, 1999 and March 31, 1998 was .60% and (.05)%, respectively. The return on average equity on an annualized basis for the three months ended March 31, 1999 and March 31, 1998 was 6.05% and (0.49)%, respectively. Net income for 1998 was \$789,000 compared with \$556,000 in 1997 and \$454,000 in 1996. Basic earnings per share were \$0.73 in 1998 compared with \$0.53 in 1997 and \$0.41 in 1996. The return on average assets was 0.97% in 1998 compared with 0.75% in 1997 and 0.65% in 1996. Valley Bank's return on average equity was 10.23% for 1998, 7.97% for 1997 and 6.68% for 1996. Factors which significantly impacted net income for 1998 as compared to 1997 included a

reduction of \$780,000 in provisions for loan loss reserves, an increase in gain on the sale of loans of \$285,000, an increase in legal and professional expenses of \$334,000 and a significant recovery which offset the expense of holding foreclosed real estate for the year.

SUMMARY SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)

The following table presents a summary of selected quarterly financial data which should be read in conjunction with Valley Bank's financial statements included elsewhere in this prospectus. In the opinion of management, this information has been prepared on the same basis as the Financial Statements appearing elsewhere in this prospectus, and includes all adjustments, consisting only of normal recurring adjustments necessary to present fairly the unaudited results set forth herein. The operating results for any quarter are not necessarily indicative of results for any subsequent period or for the entire year.

<TABLE>  
<CAPTION>

	FOR THE QUARTER ENDED							
	MARCH 1999	DECEMBER 1998	SEPTEMBER 1998	JUNE 1998	MARCH 1998	DECEMBER 1997	SEPTEMBER 1997	JUNE 1997
	(IN THOUSANDS, EXCEPT PER SHARE DATA)							
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
Net interest income.....	\$ 1,056	\$ 1,023	\$ 1,183	\$ 1,320	\$ 1,231	\$ 1,217	\$ 1,230	\$ 1,204
Provision for loan losses.....	90	75	(125)	100	150	165	435	210
Net income (loss).....	131	59	208	531	(9)	65	99	173
Net income (loss) per share--basic(1).....	\$ .12	\$ .06	\$ .19	\$ .49	\$ (.01)	\$ .06	\$ .09	\$ .17
Net income (loss) per share--diluted(2).....	\$ .12	\$ .05	\$ .17	\$ .44	\$ (.01)	\$ .06	\$ .09	\$ .16

<CAPTION>

	MARCH 1997
<S>	<C>
Net interest income.....	\$ 988
Provision for loan losses.....	170
Net income (loss).....	219
Net income (loss) per share--basic(1).....	\$ .21
Net income (loss) per share--diluted(2).....	\$ .20

</TABLE>

- (1) Net income (loss) per share--basic is based on the weighted average shares of common stock outstanding during the period.
- (2) Net income (loss) per share--diluted is based on the weighted average shares of common stock and common stock equivalents determined using the treasury stock method.

ASSET AND LIABILITY MANAGEMENT

Asset and liability management is an integral part of managing a banking institution's primary source of income, net interest income. Valley Bank manages the balance between rate-sensitive assets and rate-sensitive liabilities being repriced in any given period with the objective of stabilizing net interest income during periods of fluctuating interest rates. Valley Bank considers its rate-sensitive assets to be those which either contain a provision to adjust the interest rate periodically or mature within one year. These assets include loans and investment securities and federal funds sold. Rate-sensitive liabilities are those which allow for periodic interest rate changes within one year and include maturing time certificates, savings deposits and interest-bearing demand deposits. The difference between the aggregate amount of assets and liabilities that reprice within various time frames is called the "gap." Generally, if repricing assets exceed repricing liabilities in a time period Valley Bank would be deemed to be asset-sensitive. If repricing liabilities exceed repricing assets in a time period Valley Bank would be deemed to be liability-sensitive. Generally, Valley Bank seeks to maintain a balanced position whereby there is no significant asset or liability sensitivity within a one-year period to ensure net interest margin stability in times of volatile interest rates. This is accomplished through maintaining a significant level of loans, investment securities and deposits available for repricing within one year.

The following table sets forth the interest rate sensitivity of the bank's interest-earning assets and interest-bearing liabilities at December 31, 1998, using the interest rate sensitivity gap ratio. For purposes of the following table, an asset or liability is considered rate-sensitive within a specified period when it can be repriced or matures within its contractual terms.

<TABLE>  
<CAPTION>

<S>	AMOUNTS MATURING OR REPRICING					
	<C>	<C>	<C>	<C>	<C>	<C>
	WITHIN 3 MONTHS	AFTER 3 BUT WITHIN 12 MONTHS	AFTER 1 BUT WITHIN 5 YEARS	AFTER 5 YEARS	NONINTEREST BEARING	TOTAL
<CAPTION>						
<S>	<C>	<C>	(DOLLARS IN THOUSANDS)		<C>	<C>
ASSETS						
Federal funds sold.....	\$ 13,780	\$ --	\$ --	\$ --	\$ --	\$ 13,780
Investment securities.....	999	10,150	4,436	--	--	15,585
Net loans.....	28,727	4,217	4,080	1,298	--	38,322
Noninterest-bearing assets.....	--	--	--	--	17,022	17,022
Total earning assets.....	\$ 43,506	\$ 14,367	\$ 8,516	\$ 1,298	\$ 17,022	\$ 84,709
LIABILITIES AND STOCKHOLDERS' EQUITY						
Noninterest-bearing deposits.....	--	--	--	--	20,061	20,061
Interest-bearing deposits.....	23,477	16,755	15,446	--	--	55,678
Borrowings.....	478	--	--	--	--	478
Other liabilities and stockholders' equity.....	--	--	--	--	8,492	8,492
Total liabilities and stockholders' equity.....	\$ 23,955	\$ 16,755	\$ 15,446	\$ --	\$ 28,553	\$ 84,709
Incremental interest rate sensitivity gap.....	\$ 19,551	\$ (2,388)	\$ (6,930)	\$ 1,298		
Cumulative interest rate sensitivity gap.....	\$ 19,551	\$ 17,163	\$ 10,233	\$ 11,531		
Cumulative interest rate sensitivity gap as a % of earning assets.....	28.9%	25.4%	15.1%	17.0%		

</TABLE>

(1) Balance does not include nonaccrual loans of \$4,827,000.

Valley Bank was asset-sensitive with a positive cumulative one-year gap of \$17.2 million or 25.36% of interest-earnings assets at December 31, 1998. In general, based upon Valley Bank's mix of deposits, loans and investments, increases in interest rates would be expected to result in an increase in Valley Bank's net interest margin.

The interest rate gaps reported in the tables arise when assets are funded with liabilities having different repricing intervals. Since these gaps are actively managed and change daily as adjustments are made in interest rate views and market outlook, positions at the end of any period may not be reflective of Valley Bank's interest rate sensitivity in subsequent periods. Active management dictates that longer-term economic views are balanced against prospects for short-term interest rate changes in all repricing intervals. For purposes of the analysis above, repricing of fixed-rate instruments is based upon the contractual maturity of the applicable instruments. Actual payment patterns may differ from contractual payment patterns. The change in net interest income may not always follow the general expectations of an asset-sensitive or liability-sensitive balance sheet during periods of changing interest rates, because interest rates earned or paid may change by differing increments and at different time intervals for each type of interest-sensitive asset and liability. As a result of these factors, at any given time, Valley Bank may be more sensitive or less sensitive to changes in interest rates than indicated in the above tables.

MARKET RISK

Market risk is the risk of loss to future earnings, to fair values or to future cash flows that may result from changes in the price of a financial instrument. The value of a financial instrument may change as a result of changes in interest rates, exchange rates, commodity prices, equity prices and other market changes. Market risk is attributed to all market risk sensitive financial instruments, including investment securities, loans, deposits and borrowings.

Valley Bank does not engage in trading activities for its own account and does not participate in foreign currency transactions for its own account. Accordingly, Valley Bank's exposure to market risk is primarily a function of its asset and liability management activities. The principal market risk to the

bank is the interest rate risk inherent in its lending, investing and deposit-taking activities. This is because interest earning assets and interest-bearing liabilities of the bank do not change at the same speed, to the same extent or on the same basis.

Valley Bank's interest rate sensitivity analysis is discussed in the preceding section. The table on page 74 measures the bank's interest rate sensitivity gap, in other words, the difference between earning assets and liabilities maturing or repricing within specified periods. However, gap analysis has significant limitations as a method for measuring interest rate risk since changes in interest rates do not affect all categories of assets and liabilities in the same way or at the same time. Further, it has limitations in helping Valley Bank to manage the difference in behavior of lending and funding rates--so-called "basis risk."

To address the limitations inherent in gap analysis, Valley Bank monitors its expected change in earnings based on changes in interest rates through a detailed financial model. This model's estimate of interest rate sensitivity takes into account the differing time intervals and differing rate change increments of each type of interest-sensitive asset and liability. It then measures the projected impact of changes in market interest rates on Valley Bank's return on equity and return on average assets. Based on the March 31, 1999 mix of interest-sensitive assets and liabilities, given an immediate and sustained increase in the prime rate of 1%, this model estimates Valley Bank's cumulative annualized return on equity over the next year would increase by less than 4.0% and the cumulative annualized return on average assets over the next year would increase by less than 0.4%, as compared with a flat rate environment. Given an immediate and sustained decrease in the prime rate of 1%, this model estimates Valley Bank's cumulative annualized return on equity over the next year would decrease by less than 5.0% and the cumulative annualized return on average assets over the next year would decrease by less than 0.5%, as compared with a flat rate environment. Based upon the December 31, 1998 mix of interest-sensitive assets and liabilities, given an immediate and sustained increase in the prime rate of 1%, this model estimates Valley Bank's cumulative return on equity over the next year would increase by less than 4.0% and the cumulative return on average assets over the next year would increase by less than 0.4%, as compared with a flat interest rate environment. Given an immediate and sustained decrease in the prime rate of 1%, this model estimates Valley Bank's cumulative return on equity over the next year would decrease by less than 5.0% and the cumulative return on average assets would decrease by less than 0.5%, as compared with a flat interest rate environment.

The financial model used for the preceding analysis at March 31, 1999 and December 31, 1998 is based on a series of assumptions which may or may not come to pass. In the event of a 1% rise in interest rates, the actual return on equity and return on average assets might not increase at all, or might, in fact, decrease. Conversely, in the event of a 1% decline in interest

75

rates, the actual return on equity and return on average assets might not decrease at all, or might, in fact, increase. Further, the economic value of Valley Bank's loan and deposit portfolios would also change under the interest rate variances previously discussed. The amount of change would depend upon the profiles of each loan and deposit class, which include: the rate, the likelihood of prepayment or repayment, whether its rate is fixed or floating, the maturity of the instrument and the particular circumstances of the customer.

#### LIQUIDITY AND CAPITAL RESOURCES

**LIQUIDITY.** In order to maintain adequate liquidity, Valley Bank must have sufficient resources available at all times to meet its cash flow requirements. The need for liquidity in a banking institution arises principally to provide for deposit withdrawals, the credit needs of its customers and to take advantage of investment opportunities as they arise. A company may achieve desired liquidity from both assets and liabilities. Valley Bank considers cash, federal funds sold, other short term investments, maturing loans and investments, payments of principal and interest on loans and investments and potential loan sales as sources of asset liquidity. Deposit growth and access to credit lines established with correspondent banks and market sources of funds are considered by Valley Bank as sources of liability liquidity.

Valley Bank monitors its liquidity position daily. Valley Bank had liquid assets, consisting of cash, federal funds sold and unpledged investment securities, minus allowance for loan loss and volatile deposits, representing 30.0% of total assets and 37.7% of total liabilities as of March 31, 1999. Valley Bank had liquid assets representing 29.3% and 17.3% of total assets, and 36.8% and 22.3% of total liabilities, as of December 31, 1998 and 1997, respectively. Management believes the liquidity is sufficient to meet current and anticipated funding needs. Valley Bank's loan to deposit ratio was 57.0% and 68.3% as of December 31, 1998 and 1997, respectively. This means that there are less deposits invested in the loan portfolio, which tends to be a less liquid

asset than a typical investment security.

Valley Bank's primary sources of liquidity include liquid assets and a stable deposit base. To supplement these, Valley Bank maintains lines of credit with Union Bank of California in the amount of \$1.5 million, and with the Federal Reserve Bank of San Francisco in an amount equal to the corresponding amount of eligible securities available for pledge, which was approximately \$8.0 million at March 31, 1999 and \$8.0 million at December 31, 1998. Management believes that Valley Bank maintains adequate amounts of liquid assets to meet its cash obligations for the next 12 months. Valley Bank's liquidity might be insufficient if deposit withdrawals were to exceed anticipated levels. Deposit withdrawals can increase if a company experiences financial difficulties or receives adverse publicity for other reasons, or if its pricing, products or services are not competitive with those offered by other institutions.

**CAPITAL.** Capital serves as a source of funds and helps protect depositors against potential losses. The primary source of capital for Valley Bank has been internally generated capital through retained earnings. Valley Bank's stockholders' equity increased by \$185,000 or 2.2% from December 31, 1998 to March 31, 1999. The increase resulted primarily from net income of \$131,000. Valley Bank's shareholders' equity increased by \$962,000, or 13.2% from December 31, 1997 to December 31, 1998. The increase resulted from net income of \$789,000 and an increase in ESOP shares released of \$173,000.

Federal regulations establish guidelines for calculating risk-adjusted capital ratios. These guidelines establish a systematic approach of assigning risk weights to bank assets and

76

off-balance sheet items making capital requirements more sensitive to differences in risk profiles among banking organizations. Under these regulations, banks and bank holding companies are required to maintain a risk-based capital ratio of 8.0%; that is, "Tier 1" plus "Tier 2" capital must equal at least 8% of risk-weighted assets plus off-balance sheet items, and Tier 1 capital, which is primarily shareholders' equity, must constitute at least 50% of qualifying capital. Tier 1 capital consists primarily of shareholders' equity excluding good will, and Tier 2 capital includes subordinated debt and, subject to a limit of 1.25% of risk-weighted assets, the allowance for loan and lease losses. It is Valley Bank's intention to maintain risk-based capital ratios at levels characterized as "well capitalized" for banking organizations: Tier 1 risk-based capital of 6% or above and total risk-based capital at 10% or above. At March 31, 1999, Valley Bank had a Tier 1 risk-based capital ratio of 15.1% and a total risk-based capital ratio of 16.4%. At December 31, 1998, Valley Bank had a Tier 1 risk-based capital ratio of 15.5% and a total risk-based capital ratio of 16.7%.

In addition, regulators have adopted a minimum leverage capital ratio standard. This standard is designed to ensure that all financial institutions, irrespective of their risk profile, maintain minimum levels of core capital, which by definition excludes the allowance for loan and lease losses. These minimum standards for top-rated institutions may be as low as 3%; however, regulatory agencies have stated that most institutions should maintain ratios at least 1 to 2 percentage points above the 3% minimum. It is Valley Bank's intention to maintain the leverage ratio above the 5% minimum for "well capitalized" banks. At March 31, 1999 Valley Bank's leveraged capital ratio equaled 9.7%. At December 31, 1998, Valley Bank's leverage capital ratio equaled 10.2%.

Failure to meet minimum capital requirements can trigger mandatory and possibly additional discretionary actions by the regulators that, if undertaken, could have a material effect on Valley Bank's financial statements and operations. Refer to "Risk Factors--Government regulation may impair our operations or restrict our growth" and "Supervision and Regulation."

As part of its October 1998 resolution described elsewhere herein, Valley Bank's board of directors resolved to maintain capital at a minimum of \$5.5 million, and at least 8% of assets. Please refer to "Risk Factors--If Valley Bank fails to meet its commitments to bank regulators, it could subject us to regulatory enforcement proceedings" for a description of this resolution.

For a presentation of the actual and pro forma capitalization of The Bank of Hemet and Valley Bank, refer to "Capitalization."

#### IMPACT OF INFLATION

The financial statements and related financial data presented in this prospectus have been prepared in accordance with generally accepted accounting principles, which require the measurement of financial position and operating results in terms of historical dollars without considering changes in the relative purchasing power of money over time due to inflation. Unlike most industrial companies, virtually all of the assets and liabilities of a financial

institution are monetary in nature. As a result, interest rates are likely to have a more significant impact on a financial institution's performance than the effects of general levels of inflation. During periods of inflation, interest rates do not necessarily move in the same direction or with the same magnitude as the price of goods and services. Valley Bank seeks to manage its

77

interest sensitivity gap to minimize the potential adverse effect of inflation and other market forces on its net interest income and therefore on its earnings and capital.

Financial institutions are also affected by inflation's impact on noninterest expenses, such as salaries and occupancy expenses. During 1996, 1997 and 1998, inflation remained relatively stable, and Valley Bank's level of noninterest expense was relatively unaffected by inflation.

#### IMPACT OF PENDING ACCOUNTING PRONOUNCEMENTS

In February 1998, the Financial Accounting Standards Board issued SFAS 132, EMPLOYER'S DISCLOSURES ABOUT PENSIONS AND OTHER POST-RETIREMENT BENEFITS. This Statement standardizes the disclosure requirements for pensions and other post-retirement benefits to the extent practicable. This new standard is effective for 1998 and did not have a material effect on the financial condition or results of operations of Valley Bank.

In June 1998, the Financial Accounting Standards Board issued SFAS 133, ACCOUNTING FOR DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES. This Statement establishes accounting and reporting standards for derivative instruments and for hedging activities. This new standard is effective for 2000 and is not expected to have a material impact on the financial statements of Valley Bank.

In October 1998, the Financial Accounting Standards Board issued SFAS No. 134, ACCOUNTING FOR MORTGAGE-BACKED SECURITIES RETAINED AFTER THE SECURITIZATION OF MORTGAGE LOANS HELD FOR SALE BY A MORTGAGE BANKING ENTERPRISE, (AN AMENDMENT OF FINANCIAL ACCOUNTING STANDARDS BOARD STATEMENT NO. 65). This Statement establishes accounting and reporting standards for certain activities of mortgage banking enterprises and other enterprises that conduct operations that are substantially similar to the primary operations of a mortgage banking enterprise. Statement No. 134 will be effective for the first fiscal quarter beginning after December 15, 1998. The Bank does not engage in mortgage banking activities.

#### YEAR 2000 COMPLIANCE

OVERVIEW. The Year 2000 problem arises when computer programs have been written using two digits rather than four to define the applicable year. As a result, date-sensitive software and/or hardware may recognize a date using "00" as the year 1900 rather than the year 2000. This could result in a system failure or other disruption of operations and impede normal business activities.

In June 1996, the Federal Financial Institutions Examination Council alerted the banking industry of the serious challenges that would be encountered with Year 2000 issues. The Federal Deposit Insurance Corporation has also implemented a plan to require compliance with Year 2000 issues and regularly examines our progress.

#### STATE OF READINESS OF VALLEY BANK.

YEAR 2000 COMPLIANCE PLAN. In accordance with the Federal Deposit Insurance Corporation and Federal Financial Institutions Examination Council guidelines, Valley Bank has developed a comprehensive plan to detect and resolve Year 2000 related issues. Valley Bank believes that the plan, if properly implemented, will result in timely and adequate modifications of its computer systems and other affected systems to address the Year 2000 issues. Valley Bank's plan has five phases:

78

- Awareness--During the awareness phase, Valley Bank defined the Year 2000 problem as it applies to Valley Bank. Valley Bank also established a Year 2000 Committee.
- Assessment--Valley Bank's Year 2000 Committee assessed the size and complexity of the Year 2000 problem and detailed the magnitude of the effort necessary to address Year 2000 issues. This phase further identified all hardware, software, networks and automated teller machines, various other processing platforms and customer and vendor interdependencies affected by the Year 2000 date change.
- Renovation--This phase included hardware and software upgrades, system replacements, vendor certification and other associated changes. Valley Bank has further contracted with BankLink Corporation, a wholly owned subsidiary of The Bank of Hemet, for data and item processing commencing

on June 26, 1999.

- Testing--Valley Bank established an overall testing infrastructure, followed by the design, performance and reporting on four incremental levels of system-related testing, software unit testing, software integration testing, system acceptance testing and end-to-end testing.
- Validation--Valley Bank has engaged the services of an independent consultant to act as an independent third party validation agent. The validation agent reports directly to the Year 2000 Committee and has developed a plan of action that provides them visibility into the various levels of test activities and permits it to ensure that product and process test standards and guidance are being met.
- Implementation--In this phase, systems need to be certified as Year 2000 compliant and accepted by users.

NON-INFORMATION TECHNOLOGY SYSTEMS. Valley Bank has tested its non-information technology systems, such as microprocessors controlling its environmental, telephone and alarm systems, and found them to be Year 2000 compliant.

VENDORS. Valley Bank relies exclusively on outside vendors to provide the hardware and software used in its computer operations. Valley Bank has determined that of its 31 vendors, only seven could have a material impact on the bank's operations if they are not Year 2000 compliant. Valley Bank has determined by further investigation that all critical vendors are Year 2000 compliant.

CUSTOMERS. To determine the readiness of customers, Valley Bank has personally met with, and interviewed by way of a questionnaire, each of its borrowers with a balance over \$75,000 and depositors with over \$100,000 on deposit to determine the extent of risk created by any failure by them to remediate their own Year 2000 issues. Valley Bank classifies each borrower and depositor by its level of readiness and risk based on its response to the questionnaire. Among these customers, Valley Bank has identified several business operators with a low risk of negative impact from Year 2000, and none with a high risk. New borrowers and large depositors are screened utilizing the same questionnaire approach. In February, April and July of 1998 and April of 1999, Valley Bank has communicated by letter, to each of its depositors and borrowers, information about Year 2000 issues and problems, and furnished sources of information that they might utilize to address these issues and problems. Additional written communication is planned for 1999. Management and staff of Valley Bank have also served as speakers at community forums to raise the level of awareness of Year 2000 issues.

79

COSTS TO ADDRESS YEAR 2000 ISSUES FOR VALLEY BANK. Some of Valley Bank's computer hardware and software applications were modified or replaced in order to maintain their functionality as the year 2000 approaches. Valley Bank has spent approximately \$100,000 as of December 31, 1998 to address Year 2000 issues and estimates its total costs over the three-year period 1998 - 2000 to be approximately \$200,000. In addition, staff time of approximately 1,000 hours has been devoted to these matters, with an additional 200 hours of time expected during the remainder of 1999. These costs have been paid for out of general operating funds. Valley Bank does not anticipate that any of these costs will materially impact its results of operations in any one reporting period.

RISKS OF YEAR 2000 ISSUES FOR VALLEY BANK. Ultimately, the potential impact of the Year 2000 issue on Valley Bank will depend on a series of complex factors, including the following:

- the corrective measures undertaken by Valley Bank itself;
- the measures undertaken by third-party vendors to become Year 2000 compliant;
- the accuracy of representations made by third-party vendors to Valley Bank concerning their state of readiness;
- the degree of compliance by governmental agencies, businesses, telephone companies and other utilities, and other entities which engage in essential communications with Valley Bank; and
- the degree of compliance of customers.

At worst, Valley Bank's customers and vendors will face severe Year 2000 issues. In this case, Valley Bank may be unable to service its customers, and borrowers may become unable to pay back their loans. Valley Bank may also be required to replace non-compliant vendors with more expensive Year 2000-compliant vendors. At this time Valley Bank cannot determine the financial effect on it if significant customer or vendor remediation efforts are not resolved in a timely manner.



CONTINGENCY PLANS OF VALLEY BANK. Valley Bank has developed a business continuation contingency plan to provide service to customers should there be an environment in which electrical and communication services may not be available for a brief period of time after the century date change. The Bank's data processing system and other mission critical systems have been tested and are Year 2000 compliant. In the event its computer system or other mission critical system should fail, Valley Bank has alternate procedures to achieve a successful resumption of business. These alternative procedures include reverting to manual systems for processing some forms of work as well as contractual arrangements with Year 2000 compliant outside vendors for data processing.

80

## BUSINESS OF VALLEY BANK

### GENERAL

Valley Bank is a California community bank headquartered in Moreno Valley, California. In addition to its headquarters, Valley Bank maintains six branches in the Inland Empire and two loan production offices, one in Moreno Valley and the other in Portland, Oregon. Valley Bank was originally organized as a national banking association in 1960, and was reincorporated in 1980 under the California General Corporation Law as a state-licensed bank. It is licensed by the California Department of Financial Institutions. The Federal Deposit Insurance Corporation insures its deposits up to the \$100,000 legal limit. As with many state chartered banks of its size in California, it is not a member of the Federal Reserve System.

Moreno Valley is located in a region commonly referred to as the Inland Empire, an area southeast of Los Angeles county and northeast of San Diego county, consisting of Riverside and San Bernardino counties. These counties are experiencing significant population and economic growth, much of which has been fueled by the migration of manufacturing, distribution and export service firms from adjacent Los Angeles, Orange and San Diego counties.

Valley Bank emphasizes community-based banking, concentrating on both business and individual customers. It serves small-to-medium size businesses, professionals, retired individuals and residents in the Inland Empire area, as well as businesses and real estate owners/ developers throughout the Inland Empire. Its lending programs include making loans guaranteed by the United States Small Business Administration, and loans guaranteed by the U.S. Department of Agriculture's business and industry program, in the Inland Empire and in the vicinity of its Portland, Oregon loan office.

Valley Bank offers a full complement of business lending activities, which include, in addition to Small Business Administration and Department of Agriculture guaranteed loans, term loans, commercial loans, construction financing, and domestic letters of credit. In the area of deposit services, Valley Bank offers business checking, savings, money market and time deposit accounts. Commercial loans may be unsecured or secured by real estate, equipment, accounts receivable, deposit accounts or any combination of such collateral. Historically, Valley Bank has primarily focused its lending on government guaranteed loans, construction and conventional loans secured by real estate, commercial loans and installment loans. This continues to be its focus.

Valley Bank's consumer services complement its business emphasis by offering a range of personal and private banking financial services such as interest-bearing checking, fee-based checking, savings, money market accounts, and tailored time certificates of deposit. In the area of consumer loans, Valley Bank offers new and used automobile loans, home improvement loans, overdraft lines of credit, and unsecured personal loans. Other operational services include safe deposit boxes, night deposit facilities, travelers checks, wire transfers, cashier's checks, 24-hour access to banking information by telephone, 24-hour automatic teller machine availability on the Cirrus and Star networks and other standard depository functions.

81

### BUSINESS STRATEGY

Valley Bank's business strategy is to support the banking needs of small businesses, mainly in the Inland Empire areas served by its branches and in the Portland, Oregon area served by its loan production office. To this end, Valley Bank offers an array of business lending services including Small Business Administration and other government guaranteed loans, term loans, commercial notes, commercial real estate financing, construction loans, domestic letters of credit, and business, checking, savings, money market and time deposit accounts. Valley Bank has focused on marketing efforts to implement its business strategy of continuing to increase core deposits through business development efforts, diversifying its customer base, enhancing its product lines; and providing superior customer service.

These efforts include obtaining increased loan and deposit business from

existing customers, word-of-mouth referrals, a focused direct mail marketing program and personal solicitation of customers by officers, directors and stockholders. Management assigns responsibility to all loan and business development officers to make regular calls on potential customers and obtain referrals from existing customers. Valley Bank directs promotional efforts toward residents and small-to-medium sized businesses.

Recognizing that its greatest strategic advantage is its niche experience with government guaranteed loans, Valley Bank emphasizes this business. It opened a loan production office in Portland, Oregon in 1996 after conducting a market research study. That office serves small businesses in the State of Oregon and in southern Washington. Valley Bank is considering further expansion of that business.

In connection with Pacific Community Banking Group's acquisition of Valley Bank, during the fourth quarter of 1998, Valley Bank provided to Pacific Community Banking Group its budget for 1999. This budget included estimates of various categories of income and expenses. The 1999 budget reflected an 8.23% increase in net income over Valley Bank's 1998 experience, after adjusting the 1998 experience for one-time charges that were not budgeted for 1999. These charges were for an employee stock ownership contribution of \$173,000 and for professional fees, mainly associated with the acquisition, of \$352,000. The budgeted net income increase was based upon a planned increase in origination and sale of loans guaranteed by the U.S. Small Business Administration. This increase was budgeted to occur ratably throughout 1999. Valley Bank has not, however, achieved an increase in the amounts of these loans originated or sold in the first or second quarter of 1999.

PREMISES

The following table sets forth information about Valley Bank's banking offices.

<TABLE>  
<CAPTION>

LOCATION	TYPE OF OFFICE	OWNED/LEASED	SIZE	SINCE
<S>	<C>	<C>	<C>	<C>
24010 Sunnymead Boulevard, Moreno Valley.....	Main branch	Owned	9,000 sq/ft	1965
26670 McCall Boulevard, Sun City.....	Branch	Owned	4,500 sq/ft	1975
16920 Van Buren Boulevard (Woodcrest), Riverside.....	Branch	Owned	3,000 sq/ft	1976
22729 Barton Road, Grand Terrace.....	Branch	Owned	3,000 sq/ft	1982
255 South Riverside Avenue, Rialto.....	Branch	Owned	3,000 sq/ft	1987
211 East 4th Street, Perris.....	Branch	Leased	3,000 sq/ft	1975
29614 Nuevo Road, Nuevo.....	Branch	Leased	1,500 sq/ft	1989
24081 Postal Avenue, Moreno Valley.....	Loan production(1)	Owned	2,600 sq/ft	1993
10170 S.W. Nimbus Avenue, Suite H-1, Portland, Oregon.....	Loan production(1)	Leased	1,481 sq/ft	1996
25400 Allesandro Boulevard, Moreno Valley.....	Administrative(1)(2)	Leased	3,084 sq/ft	1992

</TABLE>

(1) Deposits are not accepted at this facility.

(2) Data processing center.

Aggregate annual rentals for Valley Bank for leased premises were \$101,000 for the year ended December 31, 1998. Valley Bank considers its present facilities to be sufficient for its current operations.

INVESTMENT PORTFOLIO

The following table sets forth the book and market values of securities held for maturity at the dates indicated. Under Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities," Valley Bank has designated all of its investment securities listed as "held-to-maturity."

<TABLE>  
<CAPTION>

<S>	DECEMBER 31,		
	<C>	<C>	<C>
	1998	1997	1996

<CAPTION>

	(DOLLARS IN THOUSANDS)		
	<C>	<C>	<C>
U.S. government agencies.....	\$ 15,004	\$ 11,957	\$ 9,979
Mortgage-backed securities.....	--	781	1,291
Securities, nontaxable.....	581	1,118	1,658
Total.....	\$ 15,585	\$ 13,856	\$ 12,928

</TABLE>

The following table sets forth the maturities of Valley Bank's investment securities at December 31, 1998 and the weighted average yields of such securities calculated on the basis of the cost and effective yields based on the scheduled maturity of each security. Yields on municipal securities have not been calculated on a tax-equivalent basis.

<TABLE>  
<CAPTION>

	WITHIN ONE YEAR		AFTER ONE TO FIVE YEARS		AFTER FIVE TO TEN YEARS		AFTER 10 YEARS
	<C> AMOUNT	<C> YIELD	<C> AMOUNT	<C> YIELD	<C> AMOUNT	<C> YIELD	<C> AMOUNT

<CAPTION>

	(DOLLARS IN THOUSANDS)							
	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
U.S. government agencies.....	\$ 10,999	5.5%	\$ 4,005	5.8%	\$ --	--	\$ --	--
Securities, nontaxable.....	\$ 150	4.8%	\$ 431	6.1%	\$ --	--	\$ --	--
Total.....	\$ 11,149	5.5%	\$ 4,436	5.8%	\$ --	--	\$ --	--
Estimated fair value.....	\$ 11,170		\$ 4,472		\$ --		\$ --	

<CAPTION>

	TOTAL			
	<C> YIELD	<C> AMOUNT	<C> YIELD	<C> AMOUNT
U.S. government agencies.....	--	\$ 15,004	5.6%	
Securities, nontaxable.....	--	581	5.8%	
Total.....	--	\$ 15,585	5.6%	
Estimated fair value.....		\$ 15,642		

</TABLE>

#### LENDING ACTIVITIES

Valley Bank originates and sells loans. Please refer to "--Lending Procedures and Loan Approval Process" for a description of applicable regulations which limit lending in relation to shareholders' equity. Valley Bank originates loans for its own portfolio and for sale in the secondary market. Lending activities include Small Business Administration and other government guaranteed loans, real estate construction loans, real estate mortgage loans, commercial loans and consumer installment loans.

#### LOAN PORTFOLIO

COMPOSITION OF LOAN PORTFOLIO. The following table shows the composition of loans by type of loan or type of borrower at the date indicated:

<TABLE>  
<CAPTION>

	DECEMBER 31,				
	<C> 1998	<C> 1997	<C> 1996	<C> 1995	<C> 1994

<CAPTION>

(IN THOUSANDS)

<S>	<C>	<C>	<C>	<C>	<C>
Real estate--construction.....	\$ 6,733	\$ 6,873	\$ 2,138	\$ 1,943	\$ 1,259
Real estate--residential.....	4,848	7,116	8,552	9,745	6,398
Real estate--unimproved residential lots.....	4,898	6,369	7,963	501	1,569
Real estate--commercial.....	13,910	14,535	14,776	14,271	10,232
Commercial and industrial.....	2,653	1,746	1,908	1,638	4,579
Government guaranteed.....	9,173	8,377	6,681	5,591	8,549
Loans to individuals.....	504	435	484	401	458
Loans held for sale.....	594	--	670	379	--
Total loans.....	\$ 43,313	\$ 45,451	\$ 43,172	\$ 34,469	\$ 33,044

</TABLE>

MATURITIES AND SENSITIVITIES OF LOANS TO CHANGES IN INTEREST RATES. The following table shows the maturity distribution of the loan portfolio at December 31, 1998, and the loan portfolio's sensitivity to changes in interest rates. Loans due after one year are shown in the fixed and floating rate categories.

<TABLE>  
<CAPTION>

	WITHIN ONE YEAR	AFTER ONE BUT WITHIN FIVE YEARS	AFTER FIVE YEARS	FLOATING RATES DUE AFTER ONE YEAR	FIXED RATES DUE AFTER ONE YEAR
<S>	<C>	<C>	<C>	<C>	<C>
	(IN THOUSANDS)				
Real estate--construction.....	\$ 6,733	\$ --	\$ --	\$ --	\$ --
Real estate--residential.....	573	775	3,500	3,702	573
Real estate--unimproved residential lots.....	1,842	1,638	1,418	362	2,694
Real estate--commercial.....	1,543	1,152	11,215	12,011	356
Commercial and industrial.....	1,340	887	426	1,067	246
Government guaranteed.....	--	3	9,170	9,173	--
Loans to individuals.....	141	229	134	138	225
Loans held for sale.....	594	--	--	--	--
Total.....	\$ 12,766	\$ 4,684	\$ 25,863	\$ 26,453	\$ 4,094

</TABLE>

#### GOVERNMENT GUARANTEED LOANS

Valley Bank actively originates loans qualifying for guarantees issued by the United States Small Business Administration, an independent agency of the federal government. The Small Business Administration guarantees on such loans currently range from 75% to 80% of the principal and accrued interest. Under certain circumstances, the guarantee of principal and interest may be less than 75%. The guaranteed percentage is less than 75% for loans over \$1.0 million. Valley Bank generally limits the amount available to any one borrower under this program to \$1.5 million. Valley Bank typically requires that Small Business Administration loans be secured by first or second lien deeds of trust on real property. Valley Bank also obtains additional collateral such as personal property or other real property. Small Business Administration loans have terms ranging from seven to 25 years depending on the use of the proceeds. To qualify for a Small Business Administration loan, a borrower must demonstrate

85

the capacity to service and repay the loan, exclusive of the collateral, on the basis of historical earnings or reliable projections.

In 1997, Valley Bank expanded its government guaranteed loan program to include loans guaranteed by the U.S. Department of Agriculture under that department's business and industry loan program for rural areas. These loans tend to be larger than Small Business Administration loans, with different, but similar, rules for origination. During 1998 Valley Bank closed its first Department of Agriculture guaranteed loan, in the amount of \$4.6 million, and concurrently sold the guaranteed portion of the loan. Valley Bank has several other Department of Agriculture guaranteed loans under review.

Valley Bank generally sells substantially all of the guaranteed portion of the government guaranteed loans that it originates. Pursuant to a 1998 change in the governmental rules for Small Business Administration loans, Valley Bank has also commenced to sell the non-guaranteed portion of Small Business Administration loans, in some cases. For the three months ending March 31, 1999, Valley Bank originated \$2.3 million of government guaranteed loans and sold \$2.5 million in government guaranteed loans. In 1998, Valley Bank originated \$13.9 million of government guaranteed loans, including its first Department of Agriculture guaranteed loan, and sold \$14.6 million of government guaranteed

loans. In 1997, Valley Bank originated \$10.1 million of government guaranteed loans and sold \$12.1 million of guaranteed loans. When Valley Bank sells a government guaranteed loan, it generally retains the obligation to repurchase the loan for 90 days after the sale, if the loan fails to comply with representations and warranties given by Valley Bank. Valley Bank retains the obligation to service the government guaranteed loans, for which it receives a servicing fee. Those portions of the sold government guaranteed loans that remain owned by Valley Bank, and those government guaranteed loans that have not yet been sold, are included in Valley Bank's balance sheet. At March 31, 1999, Valley Bank had \$9.8 million in government guaranteed loans remaining on the balance sheet. At March 31, 1999, Valley Bank was servicing \$29.6 million in government guaranteed loans that had been sold to others. At December 31, 1998, Valley Bank had \$9.8 million in government guaranteed loans remaining on its balance sheet. At December 31, 1998, Valley Bank was servicing \$28.6 million in government guaranteed loans that had been sold to others.

LOANS SECURED BY REAL ESTATE

At March 31, 1999, \$31.6 million, or approximately 73.3% of Valley Bank's loans, were secured by real estate. At December 31, 1998, \$30.4 million, or approximately 70.1% of Valley Bank's loans, were secured by real estate. The following table shows the percentage of the total loan portfolio represented by the four largest categories of real estate loans at March 31, 1999 and December 31, 1998.

<TABLE>  
<CAPTION>

TYPE OF REAL ESTATE LOAN	% OF TOTAL LOAN PORTFOLIO	
	MARCH 31, 1999	DECEMBER 31, 1998
<S>	<C>	<C>
Commercial property	34.8%	32.1%
Residential property	10.9%	11.2%
Construction loans	17.2%	15.5%
Unimproved residential lots	10.4%	11.3%

Real estate lending involves risks associated with the potential for decline in the value of underlying real estate collateral and the cash flow from income producing properties. Declines

in real estate values and cash flows can be caused by a number of factors, including adversity in general economic conditions, rising interest rates, changes in tax and other governmental policies affecting the holding real estate, environmental conditions, governmental and other use restrictions, development of competitive properties and increasing vacancy rates. Valley Bank's real estate dependence increases the risk of loss both in Valley Bank's loan portfolio and its holdings of other real estate owned when real estate values decline.

COMMERCIAL MORTGAGE LOANS. Valley Bank provides intermediate and long-term commercial real estate loans. Collateral includes first deeds of trust on real property. Typically, real estate collateral is owner-occupied, and the value of the real estate collateral is supported by formal appraisals in accordance with applicable regulations. The majority of the properties securing these loans are located in Riverside and San Bernardino counties.

Valley Bank also provides commercial real estate loans principally secured by owner-occupied/rental commercial and industrial buildings. Generally, these types of loans are made for a period of up to twenty years, with monthly payments based on a portion of the principal plus interest and with a loan-to-value ratio of 70% or less, using an adjustable rate indexed to the prime rate appearing in the West Coast edition of THE WALL STREET JOURNAL. Valley Bank also offers fixed rate loans, but rate adjustments are typically required in intervals of one to five years. Amortization schedules for commercial loans generally do not exceed 20 years.

Payments on loans secured by such properties are often dependent on successful operation or management of the properties. Repayment of such loans may be subject to a greater extent to adverse conditions in the real estate market or the economy. Valley Bank seeks to minimize these risks in a variety of ways, including limiting the size of such loans and strictly scrutinizing the financial condition of the borrower, the quality of the collateral and the management of the property securing the loan. When possible, Valley Bank also attempts to obtain loan guaranties from financially capable parties. Valley Bank's lending personnel inspects substantially all of the properties securing Valley Bank's real estate loans before the loan is made.

Valley Bank requires title insurance insuring the status of its lien on all of the real estate secured loans when a first trust deed on the real estate is

taken as collateral. Valley Bank also requires the borrower to maintain fire, extended coverage casualty insurance and, if the property is in a flood zone, flood insurance, in amounts equal to the outstanding loan balance, subject to applicable law that may limit the amount of hazard insurance a lender can require to the cost of replacing improvements. Valley Bank's lending policies generally limit the loan-to-value ratio on mortgage loans secured by owner-occupied properties to 70% of the lesser of the appraised value or the purchase price. Valley Bank cannot assure that these procedures will protect against losses on loans secured by real property. Please refer to "Risk Factors--A downturn in the real estate market could seriously impair our loan portfolio" for a discussion of the possible effects of a decline in real estate values.

REAL ESTATE CONSTRUCTION LOANS. Valley Bank finances the construction of residential, commercial and industrial properties. To limit risks inherent in its construction loan portfolio, Valley Bank has generally restricted this lending to owner-builder construction loans. The future condition of the local economy could harm the collateral values of such loans. Please refer to "Risk Factors--A downturn in the real estate market could seriously impair our loan portfolio" for a discussion of the possible effects of a decline in real estate values.

87

Valley Bank's construction loans typically have the following characteristics:

- maturities of one year or less;
- a floating rate of interest based on Valley Bank's base lending rate;
- minimum cash equity of 20% to 30% of project cost;
- advance of anticipated interest costs during construction; advance of fees;
- first lien position on the underlying real estate;
- loan-to-value ratios generally not exceeding 70%; and
- recourse against the borrower or a guarantor in the event of default.

Valley Bank does not typically commit to make the permanent loan on the property unless the permanent loan is to be a government guaranteed loan. Valley Bank does not participate in joint ventures or take an equity interest in connection with its construction lending.

Construction loans involve additional risks compared to loans secured by existing improved real property. These include the following:

- the uncertain value of the project prior to completion;
- the inherent uncertainty in estimating construction costs, which is often beyond the control of the borrower;
- construction delays and cost overruns;
- possible difficulties encountered by municipal or other governmental regulation during siting or construction; and
- the difficulty in accurately evaluating the market value of the completed project.

As a result of these uncertainties, construction lending often involves the disbursement of substantial funds with repayment dependent, in part, on the success of the ultimate project rather than the ability of the borrower or guarantor to repay principal and interest. If Valley Bank is forced to foreclose on a project prior to or at completion due to a default, there can be no assurance that Valley Bank will be able to recover all of the unpaid balance of, and accrued interest on, the loan as well as the related foreclosure and holding costs. In addition, Valley Bank may be required to fund additional amounts to complete a project and may have to hold the property for an indeterminate period of time. Valley Bank has underwriting procedures designed to identify what it believes to be acceptable levels of risk in construction lending. Among other things, qualified and bonded third parties are engaged to provide progress reports and recommendations for construction disbursements. No assurance can be given that these procedures will prevent losses arising from the risks described above.

LOANS ON UNIMPROVED RESIDENTIAL LOTS. Substantially all of the Valley Bank loans secured by unimproved residential lots relate to a single real estate project in Fort Mohave, Arizona. In 1996, Valley Bank acquired 200 loans, each secured by a residential lot in this project, at a cost of approximately \$7.9 million. These loans were acquired in a swap transaction in which Valley Bank

exchanged real property that it had previously acquired in foreclosure for these loans. Since the time of their acquisition, almost half of the loans have been repaid. As of

88

March 31, 1999, 122 of these loans remain, in the aggregate amount of \$4.5 million, or 10.5% of the loan portfolio. As of December 31, 1998, 107 of these loans remained, in the aggregate amount of \$4.9 million, or 11.5% of the loan portfolio.

**RESIDENTIAL MORTGAGE LOANS.** Valley Bank originates fixed-rate mortgage loans secured by one-to-four family properties with amortization schedules of 15 to 30 years and maturities of up to five years. The loan fees charged, interest rates and other provisions of Valley Bank's residential loans are determined by an analysis of Valley Bank's cost of funds, cost of origination, cost of servicing, risk factors and portfolio needs.

#### COMMERCIAL LOANS

Valley Bank makes relatively few commercial loans, other than government guaranteed loans. The commercial loans are for intermediate and short-terms and may be unsecured, partially secured or fully secured. The majority of these loans are in Riverside county. Loan maturities are normally 12 months. Valley Bank requires a complete re-analysis before considering any extension. Depending on the creditworthiness of the business, certain types of open-ended loans to \$100,000 and non-open-ended renewable products are also available. Valley Bank makes these loans to any size business, and to businesses organized as sole proprietorships, partnerships and corporations. Most are to small businesses. In general, it is the intent of Valley Bank to take collateral whenever possible regardless of the loan purpose. Collateral may include liens on inventory, accounts receivable, fixtures and office furniture and equipment and, in some cases, leasehold improvements and real estate. As a matter of policy, the Bank requires all principals of a business to be co-obligors on all loan instruments and all significant stockholders of corporations to execute a specific debt guaranty. All borrowers must demonstrate the ability to service and repay not only Valley Bank debt but all outstanding business debt, exclusive of collateral, on the basis of historical earnings or reliable projections.

#### LOANS TO INDIVIDUALS

Loans to individuals, also termed consumer loans, are extended for a variety of purposes. Most are for the purchase of automobiles and other vehicles. Others include secured and unsecured personal loans, home improvement, equity lines, overdraft protection loans, and unsecured lines of credit. Valley Bank's underwriting standards for loans to individuals include an examination of the applicant's credit history and payment record on other debts and an evaluation of their ability to meet existing obligations and payments on the proposed loan. Although creditworthiness of the applicant is of primary importance, the underwriting process also includes a comparison of the value of the security, if any, to the proposed loan amount. Most of Valley Bank's loans to individuals are repayable on an installment basis.

Loans to individuals generally entail greater risk than do residential mortgage loans, particularly in the case of those loans that are unsecured or secured by rapidly depreciating assets such as automobiles. In such cases, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment of the outstanding loan balance because the collateral is more likely to suffer damage, loss or depreciation. The remaining deficiency often does not warrant further collection efforts against the borrower beyond obtaining a deficiency judgment. In addition, the collection of loans to individuals is dependent on the borrower's continuing financial stability, and thus are more likely to be adversely

89

affected by job loss, divorce, illness or personal bankruptcy. Furthermore, various federal and state laws, including federal and state bankruptcy and insolvency laws often limit the amount which the lender can recover on loans to individuals. Loans to individuals may also give rise to claims and defenses by a consumer loan borrower against the lender on these loans, such as Valley Bank, and a borrower may be able to assert against such assignee claims and defenses that it has against the seller of the underlying collateral.

As of March 31, 1999, the total of all loans to individuals held by Valley Bank was \$401,000 or 1.0% of total loans. As of December 31, 1998, the total of all loans to individuals held by Valley Bank was \$504,000 or 1.2% of total loans.

#### OFF-BALANCE SHEET COMMITMENTS

As part of its service to its small- to medium-sized business customers, Valley Bank from time to time issues formal commitments and lines of credit. These commitments can be either secured or unsecured. They may be in the form of

revolving lines of credit for seasonal working capital needs. However, these commitments may also take the form of letters of credit. Standby letters of credit are conditional commitments issued by Valley Bank to guarantee the performance of a customer to a third party. Valley Bank does not enter into any interest rate swaps or caps, or forward or future contracts. At March 31, 1999, Valley Bank had commitments to extend credit of approximately \$3.7 million and obligations under standby letters of credit of approximately \$178,000. At December 31, 1998, Valley Bank had commitments to extend credit of approximately \$2.6 million and obligations under standby letters of credit of approximately \$178,000.

The following table shows the distribution of Valley Bank's undisbursed loan commitments at the dates indicated.

<TABLE>  
<CAPTION>

	AT DECEMBER 31,	
	AT MARCH 31, 1999	1998      1997
<S>	<C>	<C>      <C>
		(IN THOUSANDS)
Commitments to extend credit, including unsecured loan commitments.....	\$ 3,685	\$ 2,582    \$ 6,664
Standby letters of credit.....	178	178      212
Total.....	\$ 3,863	\$ 2,760    \$ 6,876

</TABLE>

LENDING PROCEDURES AND LOAN APPROVAL PROCESS

The board of directors' loan committee, Valley Bank's management and lending officers, or individual lending officers to the extent of their loan authority may approve loan applications. Individual lending authority is granted to the Chief Executive Officer, the Senior Credit Officer, branch and department managers and other key lending officers. Loans for which direct and indirect borrower liability would exceed an individual's lending authority are referred to Valley Bank's management and, for those in excess of management's approval limits, to the loan committee.

At March 31, 1999, Valley Bank's authorized legal lending limits were \$1,427,000 for unsecured loans, plus an additional \$951,000 for specific secured loans. Valley Bank's primary capital plus allowance for loan losses at March 31, 1999 totaled \$9.6 million. Valley Bank's largest borrower as of March 31, 1999 had an aggregate loan liability totaling \$1.7 million in secured loans.

At December 31, 1998, Valley Bank's authorized legal lending limits were \$1,405,000 for unsecured loans, plus an additional \$937,000 for specific secured loans. Legal lending limits are calculated in conformance with California law, which prohibits a bank from lending to any one individual or entity or its related interests an aggregate amount which exceeds 15% of primary capital plus the allowance for loan losses on an unsecured basis, plus an additional 10% on a secured basis. Valley Bank's primary capital plus allowance for loan losses at December 31, 1998 totaled \$9.4 million. Valley Bank's largest borrower as of December 31, 1998 had an aggregate loan liability totaling \$1.7 million in secured loans.

The highest individual lending authority in Valley Bank is the combined administrative lending authority for unsecured and secured lending of \$500,000, which requires the approval and signatures of the Chief Executive Officer and the Senior Credit Officer. The second highest lending authority is \$250,000 for each of the Chief Executive Officer and the Senior Credit Officer, each acting singly. All other individual lending authority is substantially less, with the next largest authority for secured loans being \$25,000.

Lending limits are authorized for the Chief Executive Officer, the Senior Credit Officer and other officers by the board of directors of Valley Bank. The Senior Credit Officer is responsible for evaluating the authority limits for individual credit officers and recommends lending limits for all other officers to the board of directors for approval.

The review of each loan application includes the applicant's credit history, income level and cash flow analysis, financial condition and the value of any collateral to secure the loan. In the case of real estate loans over a specified amount, the review of collateral value includes an appraisal report prepared by an independent bank-approved appraiser.

With respect to any approved commercial or real estate loan, Valley Bank generally issues a written commitment to the applicant, setting forth the terms under which the loan will be extended.



Valley Bank seeks to mitigate the risks inherent in its loan portfolio by adhering to certain underwriting practices. These practices include analysis of prior credit histories, financial statements, tax returns and cash flow projections of its potential borrowers, valuation of collateral based on reports of independent appraisers and audits of accounts receivable or inventory pledged as security.

OTHER EARNING ASSETS

The following table relates to other earning assets not disclosed previously for the dates indicated. This item consists of a salary continuation plan for Valley Bank's President. The plan is informally linked with universal life insurance policies for the salary continuation plan. Income from these policies is reflected in noninterest income.

<TABLE>  
<CAPTION>

	AT MARCH 31,	AT DECEMBER 31,		
	1999	1998	1997	1996
<S>	<C>	<C>	<C>	<C>
Cash surrender value of life insurance.....	\$ 712,000	\$ 712,000	\$ 661,000	\$ 637,000

</TABLE>

ASSET QUALITY

NONPERFORMING ASSETS. Nonperforming assets include non performing loans and other real estate owned.

NONPERFORMING LOANS. Nonperforming loans are those which the borrower fails to perform in accordance with the original terms of the obligation and fall into one of three categories:

- Nonaccrual loans. Valley Bank generally places loans on nonaccrual status when interest or principal payments become 90 days or more past due unless the outstanding principal and interest is adequately secured and, in the opinion of management, is deemed in the process of collection. When loans are placed on nonaccrual status, accrued but unpaid interest is reversed against the current year's income. Interest income on nonaccrual loans is recorded on a cash basis. Valley Bank may treat payments as interest income or return of principal depending upon management's opinion of the ultimate risk of loss on the individual loan. Cash payments are treated as interest income where management believes the remaining principal balance is fully collectible. Additionally, Valley Bank may place loans that are not 90 days past due on nonaccrual status if management reasonably believes the borrower will not be able to comply with the contractual loan repayment terms and collection of principal or interest is in question.
- Loans 90 days or more past due. Valley Bank classifies a loan in this category when the borrower is more than 90 days late in making a payment of principal or interest.
- Restructured loans. These are loans on which interest accrues at a below market rate or upon which a portion of the principal has been forgiven so as to aid the borrower in the final repayment of the loan, with any interest previously accrued, but not yet collected, being reversed against current income. Interest is reported on a cash basis until the borrower's ability to service the restructured loan in accordance with its terms is established.

OTHER REAL ESTATE OWNED (OREO). This category of nonperforming assets consists of real estate to which Valley Bank has taken title by reason of foreclosure or by taking a deed in lieu of foreclosure from the borrower. Before Valley Bank takes title to OREO, it generally obtains an environmental review.

The following table summarizes Valley Bank's nonperforming assets at the dates indicated.

<TABLE>  
<CAPTION>

<S>	DECEMBER 31,					
	<C>	<C>	<C>	<C>	<C>	<C>
	MARCH 31, 1999	1998	1997	1996	1995	1994
(DOLLARS IN THOUSANDS)						

	(UNAUDITED)					
Nonaccrual loans (1).....	\$ 4,570	\$ 4,827	\$ 3,227	\$ 1,245	\$ 1,110	\$ 3,173
Loans past due 90 days or more.....	30	256	--	--	125	--
Restructured loans.....	--	--	--	--	--	--
Total nonperforming loans (1).....	4,600	5,083	3,227	1,245	1,235	3,173
Other real estate owned.....	1,611	1,749	1,711	1,144	2,555	1,143
Total nonperforming assets.....	\$ 6,211	\$ 6,832	\$ 4,938	\$ 2,389	\$ 3,790	\$ 4,316
Nonperforming loans as a percent of total loans....	11.02%	11.78%	7.13%	2.90%	3.60%	9.65%
Nonperforming assets as a percent of total assets...	7.10%	8.07%	6.62%	3.36%	5.74%	6.65%

</TABLE>

(1) Interest income during 1998 on loans on nonaccrual status would have been \$424,000 if the loans had been accruing. Interest collected on these loans in 1998 was 0.

At March 31, 1999, nonperforming assets represented 7.10% of total assets. Nonperforming loans that were secured by first deeds of trust on real property were \$4.5 million at March 31, 1999. At December 31, 1998, nonperforming assets represented 8.07% of total assets. Nonperforming loans that were secured by first deeds of trust on real property were \$4.3 million at December 31, 1998, \$1.7 million at December 31, 1997, \$1.2 million at December 31, 1996, \$1.2 million at December 31, 1995 and \$2.8 million at December 31, 1994. Other forms of collateral such as inventory and equipment secured the remaining nonperforming loans as of each date. The collateral securing nonperforming loans may not be sufficient to prevent losses on such loans.

Nonperforming loans have occurred mainly among the loans secured by real estate. During the early 1990's Valley Bank made many interim construction loans to builders building "on spec," that is, without a committed purchaser for the finished building. When recession hit Southern California, some borrowers abandoned their construction projects, and their loans became nonperforming. The Bank foreclosed, and then attempted to liquidate the resulting OREO property. The soft real estate market then prevailing, however, made sale difficult. As the economy improved in Southern California, sale of these properties became easier. During 1998, the remaining early-1990's nonperforming assets were resolved.

As of December 31, 1998, Valley Bank had approximately \$4.8 million in nonperforming nonaccrual loans. As of March 31, 1999, Valley Bank had approximately \$4.6 million in non-performing nonaccrual loans.

The largest nonperforming loan, in the amount of approximately \$1.7 million, is a construction loan secured by an eighty room motel on which construction is now complete. Valley Bank is a 53% participant in this loan and has taken the lead to bring it to resolution. Problems arose as a result of construction delays and Valley Bank has initiated foreclosure proceedings. In response to the foreclosure proceedings, the borrower has filed a counterclaim for damages in excess of \$1.5 million as well as attorneys' fees, costs and interest. The property is expected to be managed by a hotel management company, in its capacity as the

court-appointed receiver. The management company has obtained a bond in the amount of \$300,000 and expects to open the facility in the near future. Valley Bank is working with the borrowers in an attempt to reach a settlement.

A second nonperforming loan relationship is comprised of two construction loans, totaling approximately \$1.0 million, secured by a service station/mini-mart/fast food facility. The Small Business Administration has provided a commitment to guarantee a permanent loan when construction is completed. At December 31, 1998, these loans were on nonaccrual status. At March 31, 1999 these loans were placed on accrual status based on the Small Business Administration's confirmation of its takeout loan commitment. The service station is awaiting final inspection and Valley Bank expects it to open shortly after. The franchisor has agreed to advance \$150,000 on completion of the final inspection and Valley Bank expects the Small Business Administration to execute final loan documents on or about that time.

A third nonperforming loan, in the amount of approximately \$800,000, involves a loan made to renovate and convert a facility to a sports bar and restaurant. This loan is 100% guaranteed by the City of San Bernardino Economic

Development Agency. After renovation, the lessee was unable to operate the facility successfully. The agency has approved the transfer of the lease to an experienced and successful southern California chain operator. Valley Bank and the borrower have agreed in principle on a settlement in which Valley Bank will become the owner of the property, including fixtures and equipment and the borrower/owner will pay Valley Bank \$15,000 in cash and sign a note for \$20,000.

A fourth nonperforming loan, in the amount of approximately \$697,000, involves a ten-unit low-income home development project in the city of Colton, California. Seven homes have sold and three remain unsold. In addition, the bank has located a buyer who will purchase the loan at a discounted price of \$465,000 in cash in the near future. The resulting loss is approximately \$153,000, which is less than the loss reserve of \$155,000 allocated to this loan.

A fifth nonperforming loan, in the amount of approximately \$1.1 million, involves a service station/mini-market operation. This loan was not considered a nonaccrual loan at December 31, 1998, but was placed on nonaccrual status during the first quarter of 1999. The City of San Bernardino Economic Development Agency is a guarantor. Valley Bank has initiated foreclosure proceedings. It has also had indications of interest in purchasing the loan by a group of investors.

As of December 31, 1998, Valley Bank had OREO of approximately \$1.8 million. At March 31, 1999, Valley Bank had OREO of approximately \$1.6 million. The first largest OREO property, with an approximate book balance of \$400,000, is an office building located in the Moreno Valley area. It is currently in escrow for sale at a price above book value, which Valley Bank expects to close in the near future. The second largest OREO property, with an initial book balance of \$400,000, is a residential planned unit development located in San Jacinto, California. The bank has sold five of the six homes on the property, receiving \$335,000 toward the initial balance. The third largest OREO property, with an approximate book balance of \$275,000, is a land parcel located in Moreno Valley, California.

**SUBSTANDARD AND DOUBTFUL LOANS.** Valley Bank monitors all loans in the loan portfolio to identify problem credits. Additionally, as an integral part of the credit review process of Valley Bank, credit reviews are performed by an outside financial institution consulting firm semi-annually to assure accuracy of documentation and the identification of problem credits.

94

The Federal Deposit Insurance Corporation and State of California Department of Financial Institutions also review Valley Bank and its loans during an annual safety and soundness examination.

There are three classifications for problem loans:

**Substandard**--An asset is classified as "substandard" if it is inadequately protected by the current sound worth and paying capacity of the obligor, or of the collateral pledged, if any. Credits in this category have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that Valley Bank will sustain some loss if the deficiencies are not corrected.

**Doubtful**--An asset is classified as "doubtful" if it has all the weaknesses inherent in one classified "substandard," and has the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The possibility of loss is extremely high, but because of important and reasonably specific pending factors which may work to the advantage and strengthening of the assets, its classification as an estimated loss is deferred until its more exact status may be determined.

**Loss**--An asset is classified as a "loss" if it is considered uncollectible and of such little value that its continuance as a bankable asset is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be effected in the future. Any potential recovery is considered too small and the realization too distant in the future to justify retention as an asset on Valley Bank's books.

Another category, designated as "special mention," is maintained for loans which do not currently expose Valley Bank to a significant degree of risk to warrant classification in a "substandard," "doubtful" or "loss" category, but do possess credit deficiencies or potential weaknesses deserving management's close attention.

As of March 31, 1999, Valley Bank's classified loans consisted of \$4.7 million in the "substandard" category and no loans in the "doubtful" category. Valley Bank's \$4.7 million of loans classified as "substandard" consisted of \$221,000 of performing loans and \$4.5 million of non-accrual loans.

Additionally, as of March 31, 1999, Valley Bank's loans categorized in the "special mention" category consisted of \$1.5 million of performing loans.

As of December 31, 1998, Valley Bank's classified loans consisted of \$3.8 million in the "substandard" category and no loans in the "doubtful" category. Valley Bank's \$3.8 million of loans classified as "substandard" consisted of \$222,000 of performing loans and \$3.6 million of nonaccrual loans. Additionally, as of December 31, 1998, Valley Bank's loans categorized in the "special mention" category consisted of \$2.4 million of performing loans.

IMPAIRED LOANS. Valley Bank defines impaired loans, regardless of past due status, as those on which principal and interest are not expected to be collected under the original contractual loan repayment terms. Valley Bank charges off an impaired loan at the time management believes the collection process has been exhausted. Valley Bank measures impaired loans based on the present value of future cash flows discounted at the loan's effective rate, the loan's observable market price or the fair value of collateral if the loan is collateral-dependent. Impaired loans at March 31, 1999 were \$4.6 million, all of which were also nonaccrual loans. Allowance for loans related to impaired loans was \$529,000 at

95

March 31, 1999. Impaired loans at December 31, 1998 were \$3.9 million, all of which were also nonaccrual loans. Allowance for loan losses related to impaired loans was \$502,000 at December 31, 1998.

Except as disclosed above, there were no assets as of December 31, 1998 where known information about possible credit problems of borrowers caused management to have serious doubts as to the ability of the borrower to comply with the present loan repayment terms. However, it is always possible that current credit problems may exist that may not have been discovered by management. Please refer to "--Allowance and Provisions for Loan Losses."

ALLOWANCE AND PROVISIONS FOR LOAN LOSSES

The following table sets forth an analysis of the allowance for loan losses and provisions for loan losses for the periods indicated.

<TABLE>  
<CAPTION>

	DECEMBER 31,				
<S>	<C> 1998	<C> 1997	<C> 1996	<C> 1995	<C> 1994
<CAPTION>					
	(DOLLARS IN THOUSANDS)				
<S>	<C>	<C>	<C>	<C>	<C>
Balance at beginning of period.....	\$ 1,058	\$ 756	\$ 497	\$ 574	\$ 1,047
Loans charged off					
Real estate--construction.....	--	--	--	--	225
Real estate--residential.....	--	79	66	469	306
Real estate--unimproved residential lots.....	--	--	--	--	--
Real estate--commercial.....	--	--	55	355	248
Commercial and industrial.....	9	26	--	1	4
Government guaranteed.....	403	653	--	--	--
Loans to individuals.....	--	1	--	--	--
Total charge-offs.....	412	759	121	825	783
Recoveries					
Real estate--construction.....	--	16	6	128	150
Real estate--residential.....	225	46	13	6	--
Real estate--unimproved residential lots.....	--	--	--	--	--
Real estate--commercial.....	7	6	1	--	--
Commercial and industrial.....	--	--	--	3	--
Government guaranteed.....	40	13	--	--	--
Loans to individuals.....	--	--	--	1	--
Total recoveries.....	272	81	20	138	150
Net charge-offs.....	140	678	101	687	633
Additions charged to operations.....	200	980	360	610	160
Balance at end of period.....	\$ 1,118	\$ 1,058	\$ 756	\$ 497	\$ 574
Average loans outstanding, gross.....	\$ 48,512	\$ 43,921	\$ 41,649	\$ 34,552	\$ 28,678

	\$ 43,313	\$ 45,451	\$ 43,172	\$ 34,469	\$ 33,044
Total loans at end of period, gross.....					
Net charge-offs/average loans outstanding.....	0.29%	1.54%	0.24%	1.99%	2.21%
Allowance at end of period/loans outstanding.....	2.59%	2.34%	1.76%	1.45%	1.75%
Allowance/nonperforming loans.....	21.99%	32.79%	60.72%	40.24%	18.09%

</TABLE>

Valley Bank maintains an allowance for loan losses at a level considered by management to be adequate to cover the inherent risks of loss associated with its loan portfolio under

96

prevailing and anticipated economic conditions. In determining the adequacy of the allowance for loan losses, management takes into consideration the following factors among others:

- changes in lending policies and procedures, including underwriting standards and collection, charge-off, and recovery practices;
- changes in national and local economic and business conditions and developments, including the condition of various market segments;
- changes in the nature and volume of the portfolio;
- changes in the experience, ability, and depth of the lending management and staff;
- changes in the trend of the volume and severity of past due and classified loans;
- trends in the volume of nonaccrual loans, troubled debt restructuring and other loan modifications;
- changes in the quality of the loan review system and degree of oversight by the institution's board of directors;
- the existence and effect of any concentrations of credit, and changes in the level of such concentrations; and
- the effect of external factors such as competition and legal and regulatory requirements on the level of estimated credit losses in the institution's current portfolio.

Valley Bank follows the "Interagency Policy Statement on the Allowance for Loan and Lease Losses" and analyzes the Allowance for Loan Losses using the above factors on a quarterly basis. In addition, as an integral part of the semi-annual credit review process of Valley Bank, performed by an outside financial institution consulting firm, the Allowance for Loan Losses is reviewed for adequacy. Furthermore, the Federal Deposit Insurance Corporation and State of California Department of Financial Institutions review the adequacy of the Allowance for Loan Losses in an annual safety and soundness examination. The Federal Deposit Insurance Corporation or State of California Department of Financial Institutions may require Valley Bank to recognize additions to the Allowance for Loan Losses based upon its judgment of the information available to it at the time of its examination. The Federal Deposit Insurance Corporation and State of California Department of Financial Institutions most recently examined Valley Bank in December 1997.

Valley Bank's Senior Credit Officer reports monthly to Valley Bank's board of directors and continuously reviews loan quality and loan classifications. Such reviews assist the Board in establishing the level of the allowance for loan and lease losses. Valley Bank's board of directors reviews the adequacy of the allowance on a monthly basis.

Valley Bank uses a methodology known as migration analysis for assistance in determining the appropriate level of its allowance for loan losses. This method applies relevant risk factors to the entire loan portfolio, including nonperforming loans. The methodology is based, in part, on the Bank's loan grading and classification system. The Bank grades its loans through internal reviews and periodically subjects loans to external reviews which then are assessed by the Bank's board of directors. External credit reviews are performed on a semi-annual basis and the quality grading process occurs on a quarterly basis. The "migration" of loans from grade to grade is then tracked to help predict future losses and thus more accurately set allowance levels. Risk factors applied to the performing loan portfolio are based on Valley Bank's past loss history considering the current portfolio's characteristics, current

97

economic conditions and other relevant factors. General reserves are applied to various categories of loans at percentages ranging up to 50% based on the Bank's

assessment of credit risks for each category. Risk factors are applied to the carrying value of each classified loan:

- loans internally graded "Watch" or "Special Mention" carry a risk factor from 1.0% to 2.0%;
- "Substandard" loans carry a risk factor that is typically 15%, but ranges from 0%, in the case of a government guaranteed loan on which the guarantee has not yet been honored, to 40%, depending on collateral securing the loan;
- "Doubtful" loans carry a 50% risk factor; and
- "Loss" loans are charged off 100%.

In addition, a portion of the allowance is specially allocated to identified problem credits. The analysis also includes reference to factors such as the delinquency status of the loan portfolio, inherent risk by type of loans, industry statistical data, recommendations made by Valley Bank's regulatory authorities and outside loan reviewers, and current economic environment. Important components of the overall credit rating process are the asset quality rating process and the internal loan review process.

The balance in the allowance is affected by amounts provided from operations, amounts charged off and recoveries of previously charged off loans. At March 31, 1999, Valley bank recorded a provision for loan losses of \$90,000 compared with a provision of \$150,000 for the same period in the prior year. At March 31, 1999 net charge offs totaled \$93,000. At March 31, 1999 the allowance for loan losses was \$1.1 million or 2.7% of total loans outstanding. For 1998, Valley Bank recorded a provision for credit losses of \$200,000 compared with provisions of \$980,000 for 1997 and \$360,000 for 1996. In 1998 net charge offs totaled \$140,000, compared with net charge offs of \$678,000 for 1997 and \$101,000 in 1996. The relatively higher level of charge offs in 1997 reflected primarily government guaranteed loans that had been originated in previous years without sufficient attention to government requirements for documentation of lien positions and similar matters. The employee responsible for these oversights is no longer with Valley Bank, and the Bank has since implemented more stringent procedures for loan documentation. At December 31, 1998 the allowance for loan losses was \$1.1 million or 2.59% of total loans outstanding, compared with \$1.1 million or 2.34% of total loans outstanding at December 31, 1997.

The allowance is based on estimates and ultimate future losses may vary from current estimates. Management anticipates the continued stabilization of the economy in segments of Valley Bank's market area. However, underlying trends in the economic cycle, particularly in Southern California, which management cannot completely predict will influence credit quality. It is always possible that future economic or other factors may adversely affect Valley Bank's borrowers. As a result, Valley Bank may sustain loan losses, in any particular period, that are sizable in relation to the allowance, or exceed the allowance. In addition, Valley Bank's asset quality may deteriorate through a number of possible factors, including:

- rapid growth;
  - failure to enforce underwriting standards;
  - failure to maintain appropriate underwriting standards;
  - failure to maintain an adequate number of qualified loan personnel; and
- 98
- failure to identify and monitor potential problem loans.

Based on these and other factors, loan losses may be substantial in relation to the allowance, or exceed the allowance. Please refer to "Risk Factors--Loan loss reserves may not cover actual loan losses."

The following table summarizes a breakdown of the allowance for loan losses by loan category and the allocation in each category as a percentage of total loans in each category at the dates indicated:

<TABLE>  
<CAPTION>

	DECEMBER 31,					
<S>	<C>	<C>	<C>	<C>	<C>	<C>
	1998		1997		1996	1995
	AMOUNT	% OF LOANS IN CATEGORY	AMOUNT	% OF LOANS IN CATEGORY	AMOUNT	% OF LOANS IN CATEGORY

<CAPTION>

	(DOLLARS IN THOUSANDS)							
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
Real estate--construction..	\$ 490	15.8%	\$ 141	15.1%	\$ 29	5.0%	\$ 28	
Real estate--residential...	62	11.3	70	15.7	66	20.1	90	
Real estate--unimproved residential lots.....	175	11.5	146	14.0	139	18.8	11	
Real estate--commercial....	200	32.5	423	32.0	303	34.8	201	
Commercial and industrial.....	37	6.2	54	3.8	70	4.5	72	
Government guaranteed...	150	21.5	213	18.4	141	15.7	89	
Loans to individuals....	4	1.2	11	1.0	8	1.1	6	
Total.....	\$ 1,118	100.0%	\$ 1,058	100.0%	\$ 756	100.0%	\$ 497	

<CAPTION>

<S>	<C>	<C>	<C>
		1994	
	% OF LOANS IN CATEGORY	AMOUNT	% OF LOANS IN CATEGORY
Real estate--construction..	5.7%	\$ 22	3.8%
Real estate--residential...	28.6	102	17.8
Real estate--unimproved residential lots.....	1.5	12	2.1
Real estate--commercial....	41.8	210	36.6
Commercial and industrial.....	4.8	72	12.5
Government guaranteed...	16.4	148	25.8
Loans to individuals....	1.2	8	1.4
Total.....	100.0%	\$ 574	100.0%

</TABLE>

The allocation of the allowance to loan categories is an estimate by management of the relative risk characteristics of loans in those categories. Losses in one or more loan categories may exceed the portion of the allowance allocated to that category or even exceed the entire allowance. Please refer to "Risk Factors--Loan loss reserves may not cover actual loan losses."

DEPOSITS

Deposits are Valley Bank's primary source of funds. At March 31, 1999, Valley Bank had a deposit mix of 22.0% in time deposits, 42.0% in savings and interest-bearing checking accounts, 25.9% in noninterest-bearing demand accounts and 10.1% in money market accounts. At December 31, 1998, Valley Bank had a deposit mix of 21.7% in time deposits, 41.7% in savings and interest-bearing checking accounts, 26.5% in noninterest-bearing demand accounts and 10.1% in money market accounts. Noninterest-bearing demand deposits enhance Valley Bank's net interest income by lowering its costs of funds.

Valley Bank obtains deposits primarily from the communities it serves. No material portion of its deposits has been obtained from or is dependent on any one person or industry. Valley Bank's business is not seasonal in nature. Valley Bank accepts deposits in excess of \$100,000 from customers. These deposits are priced to remain competitive. At December 31, 1998, Valley Bank had no brokered deposits.

The following table sets forth the average balances and the average rates paid for the major categories of deposits for the dates indicated:

<TABLE>  
<CAPTION>

	DECEMBER 31,				
<S>	<C>	<C>	<C>	<C>	<C>
	1998	1997	1996	1995	

<CAPTION>

	AVERAGE BALANCE	AVERAGE RATE PAID	AVERAGE BALANCE	AVERAGE RATE PAID	AVERAGE BALANCE	AVERAGE RATE PAID	AVERAGE BALANCE
(DOLLARS IN THOUSANDS)							
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
Demand accounts.....	\$ 19,212	--	\$ 18,098	--	\$ 16,502	--	\$ 15,591
Savings accounts.....	11,505	1.99%	11,220	1.99%	11,080	2.05%	11,532
Money market accounts.....	7,261	2.49	7,180	2.45	7,821	2.45	8,636
NOW accounts.....	19,297	1.04	17,373	1.04	16,652	1.04	14,937
Certificates of deposits under							
\$100,000.....	12,250	5.13	10,635	5.02	8,837	4.81	7,108
Certificates of deposits of \$100,000 or more.....	2,909	5.09	1,761	6.47	1,625	5.66	1,692
Total deposits.....	\$ 72,434	1.91%	\$ 66,267	1.85%	\$ 62,517	1.77%	\$ 59,496

<CAPTION>

	1994		
	AVERAGE RATE PAID	AVERAGE BALANCE	AVERAGE RATE PAID
<S>	<C>	<C>	<C>
Demand accounts.....	--	\$ 14,594	--
Savings accounts.....	1.99%	12,423	2.00%
Money market accounts.....	2.45	9,583	2.16
NOW accounts.....	1.05	14,254	1.08
Certificates of deposits under			
\$100,000.....	4.61	6,241	3.36
Certificates of deposits of \$100,000 or more.....	4.73	1,180	3.14
Total deposits.....	1.69%	\$ 58,275	1.47%

</TABLE>

#### MATURITIES OF TIME CERTIFICATES OF DEPOSIT

Maturities of time certificates of deposits outstanding at December 31, 1998 are summarized as follows:

<TABLE>

<CAPTION>

	\$100,000 OR MORE	LESS THAN \$100,000
(IN THOUSANDS)		
<S>	<C>	<C>
Three months or less.....	\$ 1,545	\$ 6,048
Over three to twelve months.....	898	5,924
Over twelve months.....	--	2,035
Total.....	\$ 2,443	\$ 14,007

</TABLE>

#### SUPERVISION AND REGULATION

As a California licensed Federal Deposit Insurance Corporation insured bank, Valley Bank is subject to many governmental rules that affect its operations. For a description of the laws and regulations that apply to Valley Bank, please refer to the section entitled "Supervision and Regulation," starting on page 114.

#### COMPETITION

Valley Bank considers its primary service area to include Riverside and San Bernardino counties in California and, for government guaranteed loans, Portland, Oregon and parts of Washington. The Riverside and San Bernardino county region is commonly referred to the Inland Empire.

The banking business in California is highly competitive with respect to both loans and deposits and is dominated by a relatively small number of major banks which have many offices operating over wide geographic areas. Valley Bank competes for deposits and loans principally with these banks, as well as with



savings and loan associations, thrift and loan associations, credit unions, mortgage companies, insurance companies, and other lending institutions. Among the advantages certain of these institutions have over Valley Bank are their ability to finance extensive advertising campaigns and to allocate their investment assets to regions of highest yield and demand. Many of the major commercial banks operating in Valley

Bank's service areas are larger banks and, as such, possess competitive advantages over Valley Bank. By virtue of their greater total capitalization, these major commercial banks have substantially higher lending limits than Valley Bank. In addition, other public and private entities seeking to raise capital by selling debt or equity securities will compete with Valley Bank in the acquisition of deposits. Valley Bank also competes with money market funds and, to a lesser extent, other types of mutual funds. Valley Bank's marketing emphasis niche has been individual customers, as well as businesses in the professional, commercial and industrial fields.

In order to compete with other financial institutions in its primary service areas, Valley Bank relies principally upon regional promotional activity, direct mail, and personal contacts by its officers. For clients whose loan demands exceed Valley Bank's lending limits, Valley Bank attempts to arrange for these loans on a participation basis with other banks and financial institutions. Valley Bank also assists clients requiring services not offered by Valley to obtain these services from its correspondent banks.

EMPLOYEES

At March 31, 1999, Valley Bank employed a total of 87 full-time equivalent employees, including three executive officers, compared with 86 at December 31, 1998. None of the employees is presently represented by a union or covered by a collective bargaining agreement. Valley Bank believes its employee relations are excellent.

LITIGATION

From time to time, Valley Bank is involved in litigation as an incident to its business. In the opinion of management, no such pending or threatened litigation is likely to have a material adverse effect on Valley Bank's financial condition or results of operations.

INSURANCE

Valley Bank maintains financial institution bond and commercial insurance at levels deemed adequate by Valley Bank's management to protect it from certain damage.

MANAGEMENT

DIRECTORS AND EXECUTIVE OFFICERS

The names, ages and positions of Pacific Community Banking Group's directors and executive officers as of March 31, 1999 are as follows:

<TABLE>  
<CAPTION>

NAME	AGE	POSITION
<S> E. Lynn Caswell (2)	<C> 54	Chairman and Chief Executive Officer and Chief Financial Officer
Harold R. Williams, Jr.	52	Proposed Executive Vice President and proposed Chief Financial Officer and proposed Director
Mitchell J. Allen (1) (2)	39	Director
Alfred H. Jannard (2)	58	Director
Carlos Saenz (2)	55	Director
Henry E. Schielein (1) (2)	64	Director
Marion V. Ashley	63	Proposed Director
James B. Jaqua	56	Proposed Director
N. Douglas Mills	59	Proposed Director
Jack E. Gosch	70	Proposed Director

E. Kenneth Hyatt.....	54	Proposed Director
John J. McDonough.....	67	Proposed Director
Clayton A. Record.....	71	Proposed Director

</TABLE>

-----

(1) Member of the audit committee

(2) Member of the compensation committee

MR. E. LYNN CASWELL, a founder of Pacific Community Banking Group, has served as Chairman, Chief Executive Officer and Chief Financial Officer since 1997. From 1996 until 1997, Mr. Caswell was Vice-Chairman of Western Bancorp, formerly Monarch Bancorp, a California bank-holding company. From July 1988 until February 1996, Mr. Caswell was President and Chief Executive Officer of Monarch Bancorp, and also Chairman of that company. Since January 1997 Mr. Caswell has been a member of the board of directors of the Federal Reserve Bank in San Francisco, Chairman of the Public Affairs and Information Committee and a member of the audit committee. Mr. Caswell has been a state chair of Southern California for the American Bankers' Association from June 1992 to October 1997, and has been a congressional legislative liaison for that organization since October 1992. Mr. Caswell has also been a member of the board of directors of the California Bankers' Association from May 1990 to May 1998, Mr. Caswell is also a member of the board of directors of the South Coast Medical Center in Laguna Beach, California, in which capacity he has served since October 1995. Mr. Caswell received a BSBA in marketing and finance from the University of Arkansas and graduated from the Graduate School of Banking at McIntire School of Business of the University of Virginia in 1979. He did post-graduate work both in 1981 at the Executive Management School at Stanford University and in 1984 in the Executive Management Program at the Wharton School of the University of Pennsylvania.

MR. HAROLD R. WILLIAMS, JR. is our proposed Executive Vice President and proposed Chief Financial Officer and a proposed director. Since February 1996, Mr. Williams has been the Chief Operating and Financial Officer of The Bank of Hemet. He has been Corporate Secretary since 1997. He began his service with The Bank of Hemet in 1994 as the Senior Vice President and Chief Financial Officer. Prior to joining The Bank of Hemet, Mr. Williams served for two years as the Executive Vice President, Chief Financial Officer, Secretary and a director of Commerce Bank and CommerceBancorp, the parent of Commerce Bank, Newport Beach. CommerceBancorp filed for dissolution under Chapter 7 of the Bankruptcy Code in 1994. Mr. Williams has over 27 years of business experience including 16 years in banking. He is a former senior manager with PricewaterhouseCoopers, is a Certified Public Accountant and a member of the American Institute of Public Accountants and the California Society of Certified Public Accountants. Mr. Williams graduated in accounting and holds a Masters degree in Business Administration from Brigham Young University.

MITCHELL J. ALLEN became a director in February 1999 when the board was expanded in anticipation of the public offering. Mr. Allen is also proposed to become a director of The Bank of Hemet. Since 1981, Mr. Allen has been Vice President of Allen Oldsmobile Cadillac, Inc. in Laguna Niguel, California. Mr. Allen is a graduate of the GM Dealership Academy in 1979. Mr. Allen is a member of the Tom Wilson Cabinet (Orange County Supervisor) and a director of the Orange County Marine Institute.

MR. ALFRED H. JANNARD became a director in February 1999 when the board was expanded in anticipation of the public offering. Mr. Jannard is also proposed to become a director of The Bank of Hemet and Valley Bank. From 1991 until 1997, Mr. Jannard was a director of Monarch Bank and Monarch Bancorp in Laguna Niguel, California. From 1975 until 1995, Mr. Jannard was the owner of Niguel Pharmacy in Laguna Niguel, California. Mr. Jannard received a doctorate of pharmacy from the University of Southern California.

MR. CARLOS SAENZ became a director in February 1999 when the board was expanded in anticipation of the public offering. Mr. Saenz is also proposed to become a director of The Bank of Hemet and Valley Bank. Since 1993, Mr. Saenz has served as the President and Chief Executive Officer of Gregg Realty & Investments, a real estate brokerage firm. Mr. Saenz has also been a commercial banking officer at Wells Fargo Bank and Southern California First National Bank in San Diego, California, and Mr. Saenz was a member of the Advisory board of directors of Landmark Bank, Anaheim, California from 1982 to 1986. Mr. Saenz received a Bachelor of Science Degree of Finance from San Diego State University.

MR. HENRY E. SCHIELEIN became a director in February 1999 when the board was expanded in anticipation of the public offering. Mr. Schielein is also proposed to become director of The Bank of Hemet. Mr. Schielein served as a director of Monarch Bancorp and Monarch Bank from 1988 to 1993 and again from 1994 to 1997.

Since 1994, Mr. Schielein has been President and Chief Operating Officer of The Balboa Bay Club, a California corporation that operates a private club and resort facility. From 1993 until 1994, Mr. Schielein was President of the Grand Waialea Resort in Maui, Hawaii. From October 1986 until May 1993, he was Vice President and general manager of the Ritz-Carlton Hotel in Laguna Niguel, California. Mr. Schielein is a certified hotel administrator.

MR. MARION V. ASHLEY is a proposed director. Mr. Ashley has served as a director of Valley Bank since 1979 and as the Chairman of the Board of Valley Bank since 1992. Since June 1973, Mr. Ashley has been President and Chief Executive Officer of Ashley Capital, a

103

real estate investment and development company. Mr. Ashley has also served as the President and Treasurer of County Lands, Inc., a real estate investment company, since June 1978. Mr. Ashley also served as the President and Treasurer and as a director of the Eastern Municipal Water District. Mr. Ashley is a 1958 graduate of San Diego State University and a licensed Certified Public Accountant since March 1969. Mr. Ashley served on the Riverside County Planning Commission from 1973-1981, the last year as chairman. He is currently a member, and former chairman, of the Local Agency Formation Commission. He began his service there in 1993.

MR. JACK E. GOSCH is a proposed director. He is currently a director of The Bank of Hemet and is President of Jack Gosch Ford, Inc. and Hemet Toyota, automobile dealerships. Mr. Gosch has been the president of each of the automobile dealerships since 1964 and 1972, respectively.

MR. E. KENNETH HYATT is a proposed director. He is currently a director of The Bank of Hemet and has been Executive Vice President of Talbot Agency Inc. (insurance and financial services) since 1999. Mr. Hyatt was the President of Hemet Insurance Services, Inc. Mr. Hyatt has been the President of Hemet Insurance Services, Inc. from 1984 to 1998.

MR. JOHN J. MCDONOUGH is a proposed director. He is currently Chairman of the Board of Directors of The Bank of Hemet and has been with The Bank of Hemet since 1974.

MR. CLAYTON A. RECORD is a proposed director. He is currently a director of The Bank of Hemet and is a director of the Eastern Municipal Water District. Mr. Record has been a director of the Eastern Municipal Water District since 1995.

MR. JAMES B. JAQUA is a proposed director. Since January 1994, Mr. Jaqua has been President, Chief Executive Officer and a director of The Bank of Hemet. Mr. Jaqua has over 30 years of banking experience, including six years at Wells Fargo Bank, and five years at a midwest bank holding company. Mr. Jaqua is a graduate of Stanford University.

MR. N. DOUGLAS MILLS is a proposed director. Since July 1992, Mr. Mills has served as President, Chief Executive Officer and a director of Valley Bank. From 1986 until 1992, Mr. Mills served as President at Pacific Valley Bank, Modesto, California. Mr. Mills is a 1964 graduate of California State University, Fullerton, and a 1982 graduate of Pacific Coast Banking School, Seattle, Washington.

#### COMMITTEES OF THE BOARD OF DIRECTORS

In February 1999, the board established an audit committee and a compensation committee. The audit committee monitors the corporate financial reporting and internal and external audits of Pacific Community Banking Group. The audit committee currently consists of Mitchell Allen and Henry Schielein. The compensation committee makes recommendations regarding Pacific Community Banking Group's employee stock option plans and makes decisions concerning salaries and incentive compensation for employees and consultants of Pacific Community Banking Group. The compensation committee currently consists of E. Lynn Caswell, Mitchell Allen, Alfred Jannard, Carlos Saenz and Henry Schielein.

104

#### DIRECTOR COMPENSATION

Pacific Community Banking Group intends to annually grant shares of common stock to each director, equal in value to \$2,000 per month. Pacific Community Banking Group will base the value of the shares on the market price on the last business day of each calendar quarter. Further, Pacific Community Banking Group intends to make cash payments to directors of \$250 per meeting for attendance at meetings of committees of the board, and \$500 for attendance at special or unscheduled board meetings.

#### COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

No interlocking relationship exists between Pacific Community Banking Group's board of directors or compensation committee and any member of any

company's board of directors or compensation committee, nor has any such interlocking relationship existed in the past.

LIMITATION OF LIABILITY AND INDEMNIFICATION MATTERS

Section 317 of the California General Corporation Law authorizes a court to award, or a corporation's board of directors to grant, indemnity to directors, officers and employees in terms sufficiently broad to permit such indemnification for liabilities (including reimbursement for expenses incurred) arising under the Securities Act. Articles V and VI of Pacific Community Banking Group's articles of incorporation and Article III of Pacific Community Banking Group's bylaws provide for indemnification of its directors, officers, employees and other agents to the fullest extent permitted by the California General Corporation Law. Insofar as indemnification for liabilities arising under the Securities Act may be permitted to directors, officers and controlling persons of Pacific Community Banking Group pursuant to the foregoing provisions, or otherwise, Pacific Community Banking Group has been advised that in the opinion of the Commission such indemnification is against public policy as expressed in the Securities Act and is, therefore, unenforceable.

At the present time, there is no pending litigation or proceeding involving a director, officer, employee or other agent of Pacific Community Banking Group in which indemnification would be required or permitted. Pacific Community Banking Group is not aware of any threatened litigation or proceeding that could result in a claim for such indemnification.

EXECUTIVE COMPENSATION--SUMMARY COMPENSATION TABLE

The following table sets forth all compensation paid by Pacific Community Banking Group, The Bank of Hemet or Valley Bank during fiscal 1998, 1997, and 1996 to:

- each of the individuals serving as Pacific Community Banking Group's, The Bank of Hemet's and Valley Bank's principal executive officers during fiscal 1998,
- up to four other most highly compensated executive officers of Pacific Community Banking Group, The Bank of Hemet, Valley Bank and BankLink during fiscal 1998, and
- up to two additional individuals who would have been among Pacific Community Banking Group's four most highly compensated executive officers, but for the fact that they

105

were not serving as executive officers of Pacific Community Banking Group at the end of fiscal 1998, collectively referred to as the "Named Executive Officers."

<TABLE>  
<CAPTION>

NAME AND PRINCIPAL POSITION	ANNUAL COMPENSATION			LONG-TERM COMPENSATION	ALL OTHER COMPENSATION (\$)
	YEAR	SALARY (\$)	BONUS (\$)	SECURITIES UNDERLYING OPTIONS/SARS (#)	
<S>	<C>	<C>	<C>	<C>	<C>
E. Lynn Caswell .....	1998	\$135,000	--	--	--
Chief Executive Officer, Chief Financial	1997	--	--	--	--
Officer and Chairman of the Board	1996	--	--	--	--
James B. Jaqua .....	1998	216,288	\$ 130,000	--	\$ --
President and Chief Executive Officer of The	1997	204,791	--	6,000	--
Bank of Hemet	1996	192,708	100,000	--	--
N. Douglas Mills .....	1998	184,384	13,333	--	51,156 (1)
President and Chief Executive Officer of	1997	181,400	--	--	53,698 (1)
Valley Bank	1996	160,150	--	--	47,257 (1)
Harold R. Williams, Jr. ....	1998	160,907	40,000	--	--
Chief Operating and Financial Officer of The	1997	151,640	35,000	6,000	--
Bank of Hemet	1996	143,325	35,000	--	--

</TABLE>

(1) Includes life insurance premiums, accruals under a retirement plan and purchases under an employee stock purchase plan.

## OPTION GRANTS IN LAST FISCAL YEAR

Pacific Community Banking Group did not grant any stock options or deferred stock units during fiscal year 1998.

## EMPLOYEE BENEFIT PLANS

## 1999 STOCK OPTION PLAN

Subject to regulatory approval, the Pacific Community Banking Group board of directors and shareholders adopted the 1999 Stock Option Plan on February 23, 1999, and amended it on July 27, 1999. This plan provides for the issuance of incentive stock options and non-statutory stock options for a period up to ten years of up to 1,350,000 shares of the Pacific Community Banking Group common stock to our directors and full-time salaried officers and employees, and consultants. The exercise price of options to be issued under this plan must be at least 100% of the fair market value of the common stock on the date the options are granted. Options granted are not transferable by the option holder during the holder's lifetime. In the event of termination of employment as a result of the option holder's disability or in the event of the option holder's death during the exercise period, the option will remain exercisable for up to one year, but not beyond the end of the original option term. If an option holder's employment is terminated, unless the termination is because of disability or death, or is for cause, the option holder has the right for three months to exercise the portion of the option that was exercisable immediately before the termination. If an option holder's employment is terminated for cause, except in the case of options granted to consultants or business advisors, the option holder will have the right for 30 days to exercise the portion of the option that was exercisable immediately before the termination. The options will be proportionately adjusted in the event of changes in the outstanding common stock of Pacific Community Banking Group, such as stock splits and dividends. The 1999 Stock Option Plan will terminate on February 23, 2009. Pacific Community Banking Group believes the stock options serve as effective performance-based incentives and expects to have a number of stock options equal to 10-20% of Pacific Community Banking Group common stock outstanding at any time.

As of December 31, 1998, Pacific Community Banking Group has not granted any stock options under this plan. The board of directors has agreed to grant Mr. Caswell a ten-year incentive stock option for the greater of 250,000 shares or 5% of Pacific Community Banking Group outstanding shares, as provided in his employment contract. The board of directors intends to grant ten-year options to purchase 25,000 shares of common stock to each of the original four directors. The board of directors also intends to grant ten-year options to purchase 25,000 shares of common stock to its other employee and to grant ten-year options to purchase 25,000 and 20,000 shares of common stock to each of two consultants. Further, the agreement with Mr. Williams, described under "--Consulting and Noncompetition Agreements" below, provides for a grant to him of options to purchase 50,000 shares of common stock. All of these options will be exercisable at a price per share equal to the price at which shares are sold in the initial public offering.

Except for our 1999 Stock Option Plan, we do not have any other long-term incentive plans. Directors will be paid as described under "--Director Compensation."

## 401(k) PLAN

Each of the banks has a 401(k) plan, pursuant to which eligible employees may elect to reduce their current salary by up to the statutorily prescribed annual limit and have the amount of such reduction contributed to the 401(k) plan. Contributions to the 401(k) plans by the banks are discretionary, except there is a matching contribution in each plan that is required to be made by the bank. In the case of The Bank of Hemet, the bank makes a matching contribution equal to 40% of the amount contributed by the employee, up to a maximum of 5% so contributed. In the case of Valley Bank, the bank makes a matching contribution equal to 150% of the first 3% contributed by the employee, plus 50% of the next 3% contributed by the employee. Both of the 401(k) plans are intended to qualify under Section 401 of the Internal Revenue Code so that contributions to the 401(k) plan, and income earned on plan contributions, are not taxed until withdrawn from the 401(k) plan. Each bank has kept its 401(k) plan in place. Pacific Community Banking Group may consolidate the two plans into a single plan for the combined group of companies. No decision has been made as to the terms and form of such a combined plan. No such change will reduce benefits earned prior to the effective date of the change. Pacific Community Banking Group is committed to providing a program of benefits to the employees of each bank that is no less favorable, when considered in its entirety, than the program of the

bank before the acquisition.

#### VALLEY BANK EMPLOYEE STOCK OWNERSHIP PLAN

Valley Bank also has an employee stock ownership plan. Contributions to the plan are discretionary by the bank. The plan is intended to qualify under Section 401 of the Internal Revenue Code so that contributions to the plan, and income earned on plan contributions, are not taxed until withdrawn from the plan. The plan invests primarily in Valley Bank stock. As of December 31, 1998, the plan held 123,252 shares of Valley Bank stock. Of these shares, 38,458 shares had been released for allocation to the accounts of participants and 87,794 shares were unallocated. In the acquisition, the Valley Bank stock held by the plan was exchanged for Pacific Community Banking Group stock. The plan remains in place as a plan of Valley Bank. Pacific Community Banking Group may consolidate the plan with the 401(k) plan, may amend it into a different type of tax-qualified plan, or may terminate the plan. No such change will reduce benefits earned under the plan prior to the effective date of the change.

#### WELFARE PLANS

Each of the banks maintains programs of health, dental, vision, disability and life insurance for its employees. Generally, participation in these plans is available to all full-time employees after a qualification period. Each bank has kept its welfare benefit plans in place. Pacific Community Banking Group may consolidate the plans into a single plan for the combined group of companies. No decision has been made as to the terms and form of such combined plans. Pacific Community Banking Group is committed to providing a program of benefits to the employees of each bank that is no less favorable, when considered in its entirety, than the programs of the banks before the acquisitions.

108

#### SEVERANCE PLANS

Each of the banks has established a severance policy. Under The Bank of Hemet's severance policy, an employee who is terminated due to job elimination receives an amount equal to one week's salary for each full year of employment, up to a maximum of 26 weeks' salary. In the case of a change of control, an employee in good standing who is terminated within six months due to job elimination or layoff and not offered a comparable position receives between four and 26 weeks' salary, depending upon the job category and longevity of service. The acquisition by Pacific Community Banking Group constitutes a change of control for this purpose.

Under the Valley Bank severance policy, an eligible employee who remains with the bank and in good standing through the date of the acquisition by Pacific Community Banking Group and thereafter is terminated within three months, other than for cause (if not offered a comparable position) receives one week's salary for each completed year of service, up to a maximum of 15 weeks' salary. The employees eligible for severance benefits are regular full-time employees who are eligible for other benefit programs.

Pacific Community Banking Group estimates that approximately \$350,000 will be paid out under these severance plans as a result of terminations that occur following the acquisitions.

The banks retain their respective severance policies until and unless changed by Pacific Community Banking Group.

#### EMPLOYMENT AGREEMENTS

Pacific Community Banking Group has entered into a five year and four month employment agreement with Mr. Caswell commencing September 1, 1997 at an initial base salary of \$135,000 per annum. Mr. Caswell is entitled to increases based upon the Consumer Price Index, an annual bonus of not less than 10% of his base salary if profit goals are met and employee benefits including car allowance, health and life insurance, country club membership and the ability to participate in any bonus, pension or profit sharing plan that we establish in the future. Mr. Caswell has waived some of these benefits while Pacific Community Banking Group is in its period of inception. Mr. Caswell is also entitled to an income continuation policy in an amount of \$60,000 per annum for a period of 15 years after retirement. Mr. Caswell is also entitled to ten-year incentive stock options in an amount equal to the greater of 250,000 shares or 5% of Pacific Community Banking Group's outstanding common stock. Mr. Caswell will also receive employee benefits if he is terminated before the expiration of his employment agreement. Among these benefits, if Mr. Caswell is terminated without cause he has a right to receive the amount of salary, benefits, options and other allowances remaining on his contract, or two years of the salary, benefits, options and other allowances provided under the contract, whichever is greater.

Under Mr. Caswell's employment agreement, if Pacific Community Banking Group undergoes a change in control, he will receive the amount of salary, benefits and other allowances remaining on the contract, or three years of the salary,

benefits and other allowances provided under the contract, whichever is greater. For purposes of triggering this benefit, the employment agreement defines a change in control as a consolidation, dissolution or transfer of assets that fundamentally changes the structure of Pacific Community Banking Group, a change in ownership of 50% or more of Pacific Community Banking Group's common stock, or a change in ownership of 20% or more of Pacific Community Banking Group

109

common stock constituting an effective change in control of the corporation. Further, if Mr. Caswell is terminated when Pacific Community Banking Group is sold or merged with another company, or another triggering event occurs, as described above, all of Mr. Caswell's stock options will vest.

#### CONSULTING AND NONCOMPETITION AGREEMENTS

Mr. Jaqua has entered into a consulting agreement with The Bank of Hemet under which he serves as Chairman of and as a strategic business consultant to BankLink Corporation and will serve as a director of Pacific Community Banking Group. He will receive director's fees for his services and will also receive commissions for some new business of BankLink. Mr. McDonough has entered into a consulting agreement with The Bank of Hemet under which he serves as a business development consultant for three years after the acquisition and continues to serve as a director for that time, with a right to receive director's fees and medical benefits. Mr. Jaqua and Mr. McDonough have also each entered into noncompetition agreements with The Bank of Hemet. Mr. Jaqua will receive a lump sum payment of \$484,000 for the acquisition of The Bank of Hemet under his salary continuation agreement, and \$16,750 per month for the next 72 months after the acquisition in exchange for agreeing not to compete with The Bank of Hemet in Riverside, San Bernardino or Orange counties for eight years. Mr. McDonough will receive \$2,500 per month for three years in exchange for agreeing not to compete with The Bank of Hemet in Riverside county for four years.

Mr. Harold R. Williams, Jr., Chief Operating and Financial Officer of The Bank of Hemet, has an agreement under which Mr. Williams serves as Executive Vice President and Chief Financial Officer of Pacific Community Banking Group and as Interim Chief Executive Officer, Chief Operating and Financial Officer of The Bank of Hemet. The agreement lasts until December 31, 2002 and provides Mr. Williams with severance benefits if he is terminated by Pacific Community Banking Group or The Bank of Hemet, or if he terminates employment because of a reduction in salary or benefits or a material diminution in title, authority or responsibilities. If such a termination occurs within the first 12 months of the effective date of the agreement, Mr. Williams will receive 18 months of base salary, payable in a lump sum, and health and other benefits for 18 months. If such a termination occurs during the remaining term of the agreement, Mr. Williams will receive 12 months of base salary, payable in a lump sum, and health and other benefits for 12 months. Pacific Community Banking Group can reduce the severance benefits to the extent they are not deductible expenses under Section 280G of the Internal Revenue Code. The agreement also provides Mr. Williams with a bonus in the minimum amount of \$60,000 payable February 29, 2000 and stock options for 50,000 shares of Pacific Community Banking Group common stock at an exercise price equal to the initial offering price of Pacific Community Banking Group common stock.

N. Douglas Mills, President and Chief Executive Officer of Valley Bank, will likely retain these positions at Valley Bank until Pacific Community Banking Group combines the operations of Valley Bank with those of The Bank of Hemet. He has a severance agreement providing for an annual consulting fee of \$55,800, payable monthly over a period of five years, which will take effect at that time.

110

#### CERTAIN TRANSACTIONS

We expect to have banking transactions in the ordinary course of our business with our directors, officers and their associates. We intend that these transactions will be on substantially the same terms as those prevailing at the same time for comparable transactions with others, not involve more than the normal risk of collectability or present other unfavorable features.

#### PRINCIPAL AND SELLING SHAREHOLDERS

The following table sets forth certain information with respect to beneficial ownership of Pacific Community Banking Group's common stock as of March 31, 1999, and is adjusted to reflect the sale of the shares offered in this prospectus. It shows interests of the following:

- each person, or group of affiliated persons, who is known by Pacific Community Banking Group to own beneficially more than 1% of Pacific Community Banking Group's common stock,

- each of Pacific Community Banking Group's directors and proposed directors,
- each of the Named Executive Officers and proposed Named Executive Officers,
- all directors, proposed directors and executive officers as a group and
- all other selling shareholders.

We have assumed for the purposes of this calculation that the price to the public of the common stock in this offering will be \$15.50 per share. Also, we have rounded down in computing the aggregate number of shares resulting from conversion of preferred stock and the exchange of shares with shareholders of The Bank of Hemet and Valley Bank.

<TABLE>  
<CAPTION>

NAME OF BENEFICIAL OWNER	SHARES OF COMMON STOCK BENEFICIALLY OWNED BEFORE SALE UNDER THIS PROSPECTUS (1)		SHARES TO BE SOLD	SHARES OF COMMON STOCK TO BE BENEFICIALLY OWNED AFTER SALE UNDER THIS PROSPECTUS (1) (2)	
	NUMBER	PERCENTAGE		NUMBER	PERCENTAGE
<S>	<C>	<C>	<C>	<C>	<C>
E. Lynn Caswell, Chairman, Chief Executive Officer and Chief Financial Officer(3)	34,797	*	--	34,797	*
Loren Hansen(4)	8,064	*	--	8,064	*
Rice Brown(5)	6,048	*	--	6,048	*
James Jaqua, Proposed Director(6) (15) (17)	708,636	17.17%	547,583	161,053	3.50%
Alfred H. Jannard, Director(7)	5,242	*	--	5,242	*
N. Douglas Mills, Proposed Director(8)	179,770	4.46%	82,341	97,429	2.17%
Carlos Saenz, Director(9)	2,419	*	--	2,419	*
Mitchell J. Allen, Director(9)	2,419	*	--	2,419	*
Henry E. Schielein, Director(10)	2,015	*	--	2,015	*
Harold R. Williams, Jr., Proposed Executive Vice President and Proposed Chief Financial Officer and Proposed Director	48,400	1.22%	37,400	11,000	*
Marion V. Ashley, Proposed Director	96,343	2.41%	42,440	53,903	1.21%
Jack E. Gosch, Proposed Director(15) (17) (21)	475,763 11)	11.68%	367,635	108,128	2.38%
Clayton A. Record, Proposed Director(13) (15)	250,188 11)	6.22%	193,327	56,861	1.26%
E. Kenneth Hyatt, Proposed Director(15)	135,207 11)	3.38%	104,478	30,729	*
John J. McDonough, Proposed Director(15)	95,704 11)	2.40%	73,953	21,751	*
All directors, proposed directors and Executive Officers as a group(15 persons)	2,051,014	50.86%	1,449,155	601,859	13.33%
John B. Brudin(15) (17)	314,415 11)	7.79%	206,513	107,902	2.39%
George Wilson(18) (22)	134,481 12)	3.35%	60,697 (11)	73,784	1.65%
Mark Nugent(19)	134,234 12)	3.35%	61,738	72,496	1.62%

</TABLE>

111

<TABLE>  
<CAPTION>

NAME OF BENEFICIAL OWNER	SHARES OF COMMON STOCK BENEFICIALLY OWNED BEFORE SALE UNDER THIS PROSPECTUS (1)		SHARES TO BE SOLD	SHARES OF COMMON STOCK TO BE BENEFICIALLY OWNED AFTER SALE UNDER THIS PROSPECTUS (1) (2)	
	NUMBER	PERCENTAGE		NUMBER	PERCENTAGE
<S>	<C>	<C>	<C>	<C>	<C>
Dianna Williams(19) (22)	130,644 12)	3.26%	56,206	74,438	1.66%
Eri Hook(22)	123,354 12)	3.08%	56,247	67,107	1.50%
Kenneth Ray(20) (23)	108,441 12)	2.71%	49,446	58,995	1.32%
Banque D'Orsay	140,800 11)	3.49%	-- (24)	140,800	*
Willow Decker(18)	96,361 12)	2.41%	64,241	32,120	*
Peggy J. Wilson(14)	88,000 11)	2.18%	-- (24)	88,000	1.95%
All other selling shareholders, each owning less than 1% of the total voting power of Pacific Community Banking Group prior to this offering (337 persons)	1,624,502	40.25%	1,253,912	370,590	8.21%

</TABLE>

\* Less than 1%.



- (1) We have determined beneficial ownership in accordance with the rules of the Securities and Exchange Commission. In computing the number of shares beneficially owned by a person and the percentage ownership of that person, shares of common stock subject to options or warrants held by that person that are currently exercisable within 60 days of March 31, 1999 are deemed outstanding. Such shares, however, are not deemed outstanding for the purpose of computing the percentage ownership of each other person. Except as indicated in the footnote to this table and pursuant to applicable community property laws, each shareholder named in the table has sole voting power and investment power with respect to the shares set forth opposite such shareholder's name.
  - (2) Assumes no exercise of underwriters' over-allotment option or warrants to purchase common stock.
  - (3) Reflects the conversion of 307,500 shares of Series A preferred stock into 34,797 shares of common stock.
  - (4) Reflects the conversion of 100,000 shares of Series A preferred stock into 8,064 shares of common stock. Loren Hansen's address is Knecht & Hansen, 1301 Dove Street, Suite 900, Newport Beach, California 92660.
  - (5) Reflects the conversion of 75,000 shares of Series A preferred stock into 6,048 shares of common stock. Rice Brown's address is 27134 Paseo Espada, Suite 302, San Juan Capistrano, California 92675.
  - (6) Reflects the conversion, upon the closing of The Bank of Hemet acquisition, of the following shares of The Bank of Hemet's common stock: 141,178 shares owned in the name of The Jaqua Trust of 1989, 7,243 shares of common stock owned in the name of James B. Jaqua IRA, 4,813 shares owned in the name of James B. Jaqua, and 4,467 shares owned in the name of M. Susan Jaqua IRA and options to purchase 2,400 shares of The Bank of Hemet's common stock.
  - (7) Reflects the conversion of 65,000 shares of Series A preferred stock into 5,242 shares of common stock.
  - (8) Reflects the conversion, upon the closing of the Valley Bank acquisition, of 5,081 shares of Valley Bank's common stock and options to purchase 110,250 shares of Valley Bank's common stock; includes shares held as trustee of Valley Bank's Employee Stock Ownership Plan, of which Mr. Mills is the trustee; which received 82,166 shares of Pacific Community Banking Group Common Stock and warrants for 41,083 additional shares in exchange for 123,249 shares of Valley Bank common stock.
  - (9) Reflects the conversion of 30,000 shares of Series A preferred stock into 2,419 shares of common stock.
- 112
- (10) Reflects the conversion of 25,000 shares of Series A preferred stock into 2,015 shares of common stock.
  - (11) Reflects the conversion of all outstanding stock and options of The Bank of Hemet into shares of Pacific Community Banking Group common stock and warrants in the acquisition.
  - (12) Reflects the conversion of all outstanding stock and options of Valley Bank into shares of Pacific Community Banking Group common stock and warrants in the acquisition.
  - (13) Includes shares held by Mr. Record and Ella Mae Record as trustees for The Record 1990 Trust. Clayton A. Record, Jr. is a director of The Bank of Hemet.
  - (14) As trustee, under an agreement dated September 1, 1993 executed by James H. Wilson.

- (15) The shareholder is a director of The Bank of Hemet.
- (16) The shareholder is an executive officer of The Bank of Hemet or BankLink Corporation.
- (17) The shareholder was a principal shareholder of The Bank of Hemet until the acquisition.
- (18) The shareholder was a director of Valley Bank until the acquisition.
- (19) The shareholder is an executive officer of Valley Bank.
- (20) The shareholder was a principal shareholder of Valley Bank until the acquisition.
- (21) The amount includes shares and warrants received in exchange for 9,965 shares of The Bank of Hemet common stock owned by Jack Gosch Ford, Inc. Retirement Plan and Trust, and 6,575 of the The Bank of Hemet common stock owned by TASP, Incorporated, in all of which Mr. Gosch has shared ownership.
- (22) Includes shares and warrants received in exchange for 123,252 shares of Valley Bank common stock held as Joint Trustee of Valley Bank's ESOP.
- (23) Includes shares and warrants received in exchange for 17,103 shares held of Valley Bank stock by Leota Phyllis Ray and Russell James Ray as conservators U/W Kenneth Leon Ray.
- (24) Shares to be sold are unknown, and are assumed to be zero.

113

#### SUPERVISION AND REGULATION

##### GENERAL

Both federal and state law extensively regulate bank holding companies. This regulation is intended primarily for the protection of depositors and the deposit insurance fund and not for the benefit of shareholders of Pacific Community Banking Group. Set forth below is a summary description of the material laws and regulations which relate to the operations of the banks and will relate to the operations of Pacific Community Banking Group. The description does not purport to be complete and is qualified in its entirety by reference to the applicable laws and regulations.

In recent years, significant legislative proposals and reforms affecting the financial services industry have been discussed and evaluated by Congress. These proposals include legislation to revise the Glass-Steagall Act and the Bank Holding Company Act, and to expand permissible activities for banks, principally to facilitate the convergence of commercial and investment banking. Certain proposals also sought to expand insurance activities of banks. It is unclear whether any of these proposals, or any form of them, will be introduced in the next Congress and become law. Consequently, it is not possible to determine what effect, if any, they may have on Pacific Community Banking Group and the banks that it will own.

##### PACIFIC COMMUNITY BANKING GROUP

Pacific Community Banking Group is a registered bank holding company. It is subject to regulation under the Bank Holding Company Act. Pacific Community Banking Group will be required to file with the Federal Reserve Board periodic reports and such additional information as the Federal Reserve Board may require pursuant to the Bank Holding Company Act. The Federal Reserve Board may conduct examinations of Pacific Community Banking Group and its subsidiaries, which will

include the banks.

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

Under the Bank Holding Company Act and regulations adopted by the Federal Reserve Board, a bank holding company and its nonbanking subsidiaries are prohibited from requiring tie-in arrangements in connection with any extension of credit, lease or sale of property or furnishing of services. Further, the Federal Reserve Board requires Pacific Community Banking Group to maintain capital at or above stated levels.

Pacific Community Banking Group must obtain the prior approval of the Federal Reserve Board for the acquisition of more than 5% of the outstanding shares of any class of voting securities or substantially all of the assets of any bank or bank holding company. The Federal Reserve Board must also give advance approval for the merger or consolidation of Pacific Community Banking Group and another bank holding company.

114

Pacific Community Banking Group will be prohibited by the Bank Holding Company Act, except in statutorily prescribed instances, from acquiring direct or indirect ownership or control of more than 5% of the outstanding voting shares of any company that is not a bank or bank holding company and from engaging directly or indirectly in activities other than those of banking, managing or controlling banks or furnishing services to its subsidiaries. However, Pacific Community Banking Group, subject to the prior approval of the Federal Reserve Board, may engage in any, or acquire shares of companies engaged in, activities that are deemed by the Federal Reserve Board to be so closely related to banking or managing or controlling banks as to be a proper incident thereto.

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

Pacific Community Banking Group will also be a bank holding company within the meaning of Section 3700 of the California Financial Code. As such, Pacific Community Banking Group and its subsidiaries, including The Bank of Hemet and Valley Bank will be subject to examination by, and may be required to file reports with, the California Department of Financial Institutions.

Pacific Community Banking Group has applied to have its securities registered with the Securities and Exchange Commission under the Securities Exchange Act. As such, Pacific Community Banking Group will be subject to the information, proxy solicitation, insider trading, and other requirements and restrictions of the Exchange Act.

#### THE BANKS

The Bank of Hemet and Valley Bank, as California chartered banks, are subject to primary supervision, periodic examination, and regulation by the California Commissioner of Financial Institutions and the Federal Deposit Insurance Corporation. To a lesser extent, the banks are also subject to regulations promulgated by the Federal Reserve Board. If, as a result of an examination of the banks, the Federal Deposit Insurance Corporation should determine that the financial condition, capital resources, asset quality, earnings prospects, management, liquidity, or other aspects of the banks' operations are unsatisfactory or that the bank or its management is violating or has violated any law or regulation, various remedies are available to the Federal Deposit Insurance Corporation. These remedies include the power to enjoin "unsafe or unsound" practices, to require affirmative action to correct any conditions resulting from any violation or practice, to issue an administrative order that can be judicially enforced, to direct an increase in capital, to restrict the growth of either of the banks, to assess civil monetary

penalties, to remove officers and directors and ultimately to terminate either of the banks deposit insurance, which for a California chartered bank would

115

result in a revocation of the banks' charter. The California Commissioner of Financial Institution has many of the same remedial powers.

Various requirements and restrictions under the laws of the State of California and the United States affect the operations of the bank. State and federal statutes and regulations relate to many aspects of the banks' operations, including reserves against deposits, ownership of deposit accounts, interest rates payable on deposits, loans, investments, mergers and acquisitions, borrowings, dividends, locations of branch offices, and capital requirements. Further, the banks are required to maintain capital at or above stated levels.

#### DIVIDENDS AND OTHER TRANSFERS OF FUNDS

Dividends from the banks will constitute the principal source of income to Pacific Community Banking Group. Pacific Community Banking Group is a legal entity separate and distinct from the banks. The banks are subject to various statutory and regulatory restrictions on its ability to pay dividends, and will be subject to restrictions on the payment of dividends to Pacific Community Banking Group. In addition, the California Department of Financial Institutions and the Federal Reserve Board have the authority to prohibit the banks from paying dividends, depending upon the banks' financial condition, if the payment is deemed to constitute an unsafe or unsound practice.

The Federal Deposit Insurance Corporation and the California Commissioner of Financial Institutions also have authority to prohibit the banks from engaging in activities that, in their opinion, constitute unsafe or unsound practices in conducting its business. It is possible, depending upon the financial condition of the bank in question and other factors, that the Federal Deposit Insurance Corporation and the Commissioner could assert that the payment of dividends or other payments might, under some circumstances, be such an unsafe or unsound practice. Further, the Federal Deposit Insurance Corporation and the Federal Reserve Board have established guidelines with respect to the maintenance of appropriate levels of capital by banks or bank holding companies under their jurisdiction. Compliance with the standards set forth in those guidelines and the restrictions that are or may be imposed under the prompt corrective action provisions of federal law could limit the amount of dividends which the banks or Pacific Community Banking Group may pay. An insured depository institution is prohibited from paying management fees to any controlling persons or, with limited exceptions, making capital distributions if after the transaction the institution would be undercapitalized. Please refer to "--Prompt Corrective Regulatory Action and Other Enforcement Mechanisms" and "--Capital Standards" for a discussion of these additional restrictions on capital distributions.

The banks are subject to restrictions imposed by federal law on any extensions of credit to, or the issuance of a guarantee or letter of credit on behalf of, Pacific Community Banking Group or other affiliates, the purchase of, or investments in, stock or other securities of Pacific Community Banking Group, the taking of such securities as collateral for loans, and the purchase of assets of Pacific Community Banking Group or other affiliates. Such restrictions prevent Pacific Community Banking Group and the banks' other affiliates from borrowing from the banks unless the loans are secured by marketable obligations of designated amounts. Further, such secured loans and investments by the banks to or in Pacific Community Banking Group or to or in any other affiliate are limited, individually, to 10.0% of each bank's capital and surplus (as defined by federal regulations), and such secured loans and

116

investments are limited, in the aggregate, to 20.0% of each bank's capital and surplus. California law also imposes restrictions with respect to transactions involving Pacific Community Banking Group and other controlling persons of the banks. Additional restrictions on transactions with affiliates may be imposed on the bank under the prompt corrective action provisions of federal law.

#### CAPITAL STANDARDS

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

The federal banking agencies require a minimum ratio of qualifying total

capital to risk-adjusted assets of 8% and a minimum ratio of Tier 1 capital to risk-adjusted assets of 4%. In addition to the risk-based guidelines, federal banking regulators require banking organizations to maintain a minimum amount of Tier 1 capital to total assets, referred to as the leverage ratio. For a banking organization rated in the highest of the five categories used by regulators to rate banking organizations, the minimum leverage ratio of Tier 1 capital to total assets must be 3%. In addition to these uniform risk-based capital guidelines and leverage ratios that apply across the industry, the regulators have the discretion to set individual minimum capital requirements for specific institutions at rates significantly above the minimum guidelines and ratios.

#### PROMPT CORRECTIVE ACTION AND OTHER ENFORCEMENT MECHANISMS

Federal banking agencies possess broad powers to take corrective and other supervisory action to resolve the problems of insured depository institutions, including but not limited to those institutions that fall below one or more prescribed minimum capital ratios. Each federal banking agency has promulgated regulations defining the following five categories in which an insured depository institution will be placed, based on its capital ratios: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. At December 31, 1998, The Bank of Hemet exceeded the required ratios for classification as "well capitalized." At that date, Valley Bank was deemed for regulatory purposes to be "adequately capitalized" because it was designated a troubled institution for reasons unrelated to capital levels.

An institution that, based upon its capital levels, is classified as well capitalized, adequately capitalized, or undercapitalized may be treated as though it were in the next lower capital category if the appropriate federal banking agency, after notice and opportunity for hearing, determines that an unsafe or unsound condition or an unsafe or unsound practice warrants such treatment. At each successive lower capital category, an insured depository institution is subject to more restrictions. The federal banking agencies, however, may not

117

treat a significantly undercapitalized institution as critically undercapitalized unless its capital ratio actually warrants such treatment.

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

#### SAFETY AND SOUNDNESS STANDARDS

The federal banking agencies have adopted guidelines designed to assist the federal banking agencies in identifying and addressing potential safety and soundness concerns before capital becomes impaired. The guidelines set forth operational and managerial standards relating to the following:

- internal controls, information systems and internal audit systems,
- loan documentation,
- credit underwriting,
- asset growth,
- earnings, and
- compensation, fees and benefits. In addition, the federal banking agencies have also adopted safety and soundness guidelines with respect to asset quality and earnings standards.

These guidelines provide six standards for establishing and maintaining a system to identify problem assets and prevent those assets from deteriorating. Under these standards, an insured depository institution should do the following:

- conduct periodic asset quality reviews to identify problem assets,
- estimate the inherent losses in problem assets and establish reserves that are sufficient to absorb estimated losses,
- compare problem asset totals to capital,
- take appropriate corrective action to resolve problem assets,
- consider the size and potential risks of material asset concentrations, and

- provide periodic asset quality reports with adequate information for management and the board of directors to assess the level of asset risk.

These new guidelines also establish standards for evaluating and monitoring earnings and for ensuring that earnings are sufficient for the maintenance of adequate capital and reserves.

118

#### PREMIUMS FOR DEPOSIT INSURANCE

The Bank Insurance Fund of the Federal Deposit Insurance Corporation insures the bank's deposit accounts, up to the maximum permitted by law. The Federal Deposit Insurance Corporation may terminate insurance of deposits upon a finding that the institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, rule, order, or condition imposed by the Federal Deposit Insurance Corporation or the institution's primary regulator.

The Federal Deposit Insurance Corporation charges an annual assessment for the insurance of deposits, which as of December 31, 1998, ranged from 0 to 27 basis points per \$100 of insured deposits, based on the risk a particular institution poses to its deposit insurance fund. The risk classification is based on an institution's capital group and supervisory subgroup assignment. Pursuant to the Economic Growth and Paperwork Reduction Act, at January 1, 1997, the banks began paying, in addition to their normal deposit insurance premium as a member of the Bank Insurance Fund, an amount equal to approximately 1.3 basis points per \$100 of insured deposits toward the retirement of the Financing Corporation bonds issued in the 1980s to assist in the recovery of the savings and loan industry. Members of the Savings Association Insurance Fund, by contrast, pay, in addition to their normal deposit insurance premium, approximately 6.4 basis points. Under the Paperwork Reduction Act, the Federal Deposit Insurance Corporation is not permitted to establish Savings Association Insurance Fund assessment rates that are lower than comparable Bank Insurance Fund assessment rates. Beginning no later than January 1, 2000, the rate paid to retire the Financing Corporation Bonds will be equal for members of the Bank Insurance Fund and the Savings Association Insurance Fund. The Paperwork Reduction Act also provided for the merging of the Bank Insurance Fund and the Savings Association Insurance Fund by January 1, 1999 provided there were no financial institutions still chartered as savings associations at that time. However, as of January 1, 1999, there were still financial institutions chartered as savings associations. Should the insurance funds be merged before January 1, 2000, the rate paid by all members of this new fund to retire the Financing Corporation Bonds would be equal.

#### INTERSTATE BANKING AND BRANCHING

The Bank Holding Company Act permits bank holding companies from any state to acquire banks and bank holding companies located in any other state, subject to conditions, including nationwide- and state-imposed concentration limits. The banks have the ability, subject to certain restrictions, to acquire by acquisition or merger branches outside their home state. The establishment of new interstate branches is also possible in those states with laws that expressly permit it. Interstate branches are subject to laws of the states in which they are located. Competition may increase further as banks branch across state lines and enter new markets.

119

#### COMMUNITY REINVESTMENT ACT AND FAIR LENDING DEVELOPMENTS

The banks are subject to fair lending requirements and reporting obligations involving home mortgage lending operations and Community Reinvestment Act activities. The Community Reinvestment Act generally requires the federal banking agencies to evaluate the record of a financial institution in meeting the credit needs of its local communities, including low- and moderate-income neighborhoods. A bank may be subject to substantial penalties and corrective measures for a violation of fair lending laws. The federal banking agencies may take compliance with those laws and Community Reinvestment Act obligations into account when regulating and supervising other activities.

A bank's compliance with its Community Reinvestment Act obligations is based on a performance-based evaluation system which bases Community Reinvestment Act ratings on an institution's lending service and investment performance. When a bank holding company applies for approval to acquire a bank or other bank holding company, the Federal Reserve Board will review the assessment of each subsidiary bank of the applicant bank holding company, and those records may be the basis for denying the application. Based on examinations conducted August 24, 1998 for The Bank of Hemet and March 9, 1998 for Valley Bank, The Bank of Hemet was rated outstanding and Valley Bank was rated satisfactory in complying with their respective Community Reinvestment Act obligations.

#### YEAR 2000 COMPLIANCE

The Federal Financial Institutions Examination Council issued an interagency statement to the chief executive officers of all federally supervised financial institutions regarding year 2000 project management awareness. It is expected that unless financial institutions address the technology issues relating to the coming of the year 2000, there will be major disruptions in the operations of financial institutions. The statement provides guidance to financial institutions, providers of data services, and all examining personnel of the federal banking agencies regarding the year 2000 problem. The federal banking agencies intend to conduct year 2000 compliance examinations, and the failure to implement a year 2000 program may be seen by the federal banking agencies as an unsafe and unsound banking practice. If a federal banking agency determines that either of the banks is operating in an unsafe and unsound manner, the banks may be required to submit a compliance plan. Failure to submit a compliance plan or to implement an accepted plan may result in enforcement action being taken, which may include a cease and desist order and fines.

120

#### DESCRIPTION OF CAPITAL STOCK

Our authorized capital stock consists of 100,000,000 shares of common stock, no par value, and 100,000,000 shares of preferred stock, no par value. Immediately prior to the closing of this offering, 10,000 shares of our common stock, 1,085,000 shares of Series A preferred stock and 375,000 shares of Series B preferred stock will be issued and outstanding. The following summary description of our capital stock is qualified in its entirety by reference to our articles of incorporation and bylaws, copies of which are filed as exhibits to the registration statement of which this prospectus forms a part.

#### COMMON STOCK

As of March 31, 1999, we had 10,000 shares of common stock outstanding, held of record by one shareholder. The holders of our common stock are entitled to one vote, in person or by proxy, per share on any matter requiring shareholder action. Our articles do not provide for cumulative voting for any purpose so long as our stock is listed on Nasdaq.

Holders of common stock are entitled to dividends when, as and if declared by the board of directors from funds legally available therefor (and after satisfaction of the prior rights of holders of outstanding preferred stock, if any) subject to restrictions on payment of dividends imposed by the California Corporations Code and other applicable regulatory limitations. Our ability to pay cash dividends is limited by the provisions of Section 500 of the California Corporations Code, which prohibits the payment of dividends unless (A) our retained earnings immediately prior to the distribution exceeds the amount of the distribution; (B) our assets exceed 1 1/4 times our liabilities; or (C) our current assets exceed our current liabilities, but if our average pre-tax earnings before interest expense for the two years preceding the distribution was less than our average interest expense for those years, our current assets must exceed 1 1/4 times our current liabilities.

The holders of common stock have no preemptive or other subscription rights and there are no redemption, sinking fund or conversion privileges applicable to the common stock. Upon our liquidation, dissolution or winding up, holders of common stock are entitled to share ratably in all assets remaining after payment of liabilities.

#### PREFERRED STOCK

As of March 31, 1999, we had 1,085,000 shares of Series A preferred stock outstanding, held of record by 18 shareholders. In addition, as of March 31, 1999, we had 375,000 shares of Series B preferred stock outstanding, held of record by 16 shareholders. The board of directors has the authority to issue 98,540,000 additional shares of preferred stock in one or more series and to fix the powers, designations, preferences and rights, and qualifications, limitations or restrictions thereof, without any further vote or action by our shareholders.

The Series A preferred stock and the Series B preferred stock are currently the only series of preferred stock with designated terms. Each share of Series A preferred stock is convertible into shares of our common stock at a conversion price equal to 80% of the price of our common stock in our initial offering to the public. Each share of Series B preferred stock is convertible into shares of our common stock at a conversion price equal to 85% of the price of our common stock in our initial offering to the public. As a result of the offering described in this prospectus, the outstanding shares of preferred stock will convert into

121

115,963 shares of common stock. The holders of Series A and Series B preferred stock do not have voting rights and are not entitled to receive dividends.

We may issue Pacific Community Banking Group preferred stock from time to

time in one or more series. The board is authorized to fix the number of shares of any series of preferred stock and to determine the designation of any such shares. The board is also authorized to determine or alter the rights, preferences, privileges and restrictions granted to or imposed upon any wholly unissued series of preferred stock and, within the limits and restrictions stated in any resolution or resolutions of the board of directors originally fixing the number of shares constituting any series, to increase or decrease (but not the number of shares of such series then outstanding) the number of shares of any series subsequent to the issue of shares of that series.

Any issuance of preferred stock may adversely affect the rights of holders of our other securities. The effects might include (A) restrictions on common stock dividends if preferred stock dividends have not been paid; (B) dilution of the voting power and equity interest of holders of common stock to the extent that any preferred stock series has voting rights, or that any preferred stock shares are convertible into common stock, or (C) inability of current holders of common stock to share in our assets upon liquidation until satisfaction of any liquidation preferences granted to the holders of the preferred stock. Further, dividends payable on any newly issued series of preferred stock would reduce the amount of funds available for the payment of dividends on common stock, including the shares presently outstanding. Failure to make scheduled dividend or sinking fund payments on the preferred stock could, among other things, trigger restrictions on the payments of dividends on the common stock, including the shares presently outstanding, or temporarily deprive holders of common stock, including the shares presently outstanding, of voting rights. Also, fundamental matters requiring shareholder approval such as mergers, sales of assets and future amendments to the articles of incorporation may require approval by the separate vote of the holders of preferred stock, or in some cases by holders of shares in each class or series of preferred stock in addition to the approval of the holders of shares of common stock, including the shares presently outstanding, before we can taken any action.

In the event of a proposed merger, tender offer or other attempt to gain control of us that the board did not approve, the board could authorize the issuance of preferred stock which could contain rights and preferences which could impede completion of the proposed merger, tender offer or other attempt to gain control of us. An effect of the issuance of preferred stock, therefore, may be to deter a future takeover attempt which some or a majority of the holders of common stock may deem to be in their best interests and in which holders of common stock may receive a premium for their shares over the then market price. We are not aware of any proposed or pending mergers, tender offers or other attempts to gain control of us.

#### WARRANTS

We have issued approximately 1,308,000 ten-year warrants that are exercisable at a price equal to \$ per share or 122% of this offering price, to the shareholders and holders of options to purchase common stock of The Bank of Hemet and Valley Bank.

122

#### NUMBER OF DIRECTORS

Although the California General Corporation Law does not require us to maintain any specific range of number of directors, the number of directors may not be less than a stated minimum nor more than a stated maximum with the exact number of directors to be fixed, within the limits specified. Our bylaws currently provide that the number of directors on our board may not be fewer than eight nor more than fifteen, with the exact number of directors fixed at nine. An additional four members will be appointed to our board of directors as described in this prospectus.

#### OPTIONS

Subject to regulatory approval, our board of directors and shareholders adopted the 1999 Stock Option Plan. Please refer to "Management--Employee Benefit Plans--1999 Stock Option Plan" for information regarding the provisions of this plan. 1,350,000 shares of our common stock have been reserved for issuance pursuant to this plan. Except for our stock option plan, we do not have any other long-term incentive plans.

#### REGISTRATION RIGHTS

We have granted registration rights to the holders of approximately shares of our common stock acquired upon conversion of the Series A and Series B preferred stock. These registration rights are subject to exclusion if the managing underwriter advises us that marketing factors require a limitation on the number of shares to be underwritten.



The following discussion is a summary of provisions of California and Federal law and regulations and California corporate law relating to stock ownership and transfers, the board of directors and business combinations, all of which may be deemed to have "anti-takeover" effects. The description of these provisions is necessarily general and you should refer to the actual law and regulations.

The Federal Change in Bank Control Act prohibits a person or group of persons "acting in concert" from acquiring "control" of a bank holding company unless the Federal Reserve Bank has been given 60 days' prior written notice of such proposed acquisition and within that time period the Federal Reserve Bank has not issued a notice disapproving the proposed acquisition or extending for up to another 30 days the period during which such a disapproval may be issued. An acquisition may be made prior to the expiration of the disapproval period if the Federal Reserve Bank issues written notice of its intent not to disapprove the action. Under a rebuttable presumption established by the FRB, the acquisition of more than 10% of a class of voting stock of a bank like our bank, with a class of securities registered under Section 12 of the Securities Exchange Act would, under the circumstances set forth in the presumption, constitute the acquisition of control.

123

Under the California Financial Code, no person may, directly or indirectly, acquire control of a California licensed bank or a bank holding company unless the Commissioner of Financial Institutions has approved the acquisition of control. A person would be deemed to have acquired control of Pacific Community Banking Group under this state law if such person, directly or indirectly, has the power to do the following:

- to vote 25% or more of the voting power of Pacific Community Banking Group, or
- to direct or cause the direction of the management and policies of Pacific Community Banking Group.

For purposes of this law, a person who directly or indirectly owns or controls 10% or more of Pacific Community Banking Group common stock would be presumed to control Pacific Community Banking Group.

In addition, any "company" would be required to obtain the approval of the Federal Reserve Bank under the Bank Holding Company Act before acquiring 25% or more of the outstanding common stock of, or such lesser number of shares as constitute control over, Pacific Community Banking Group. The same requirement applies to any acquiror that is, or is deemed to be, a bank holding company that acquires 5% or more of Pacific Community Banking Group common stock.

## CHANGE OF CONTROL PROVISIONS IN COMPANY'S ARTICLES OF INCORPORATION

Our articles of incorporation contain provisions that deal with matters of corporate governance and rights of shareholders. The following discussion is a general summary of Pacific Community Banking Group's articles of incorporation and regulatory provisions relating to stock ownership and transfer, the board of directors and business combinations, which might be deemed to have a potential "anti-takeover" effect. These provisions may have the effect of discouraging a future takeover attempt which is not approved by the board of directors but which some of our individual shareholders may deem to be in their best interest or in which shareholders may receive a substantial premium for their shares over then current market prices. As a result, our shareholders who might desire to participate in such a transaction may not have an opportunity to do so. Such provisions also render the removal of an incumbent board of directors or management of Pacific Community Banking Group more difficult. The following description of amendments to our articles of incorporation is necessarily general, and reference should be made in each case to the articles of incorporation.

**CLASSIFICATION OF BOARD OF DIRECTORS.** As long as Pacific Community Banking Group's stock is listed on Nasdaq, our board of directors will be divided into two classes, each of which contain approximately one-half of the whole number of the members of the board. The members of each class will be elected for a term of two years, with the terms of office of all members of one class expiring each year so that approximately one-half of the total number of directors are elected each year. The classified board is intended to provide for continuity of our board of directors and to make it more difficult and time consuming for a shareholder group to fully use its voting power to gain control of the board of directors without consent of our incumbent board of directors.

**AUTHORIZED SHARES.** Our articles authorize the issuance of 100,000,000 shares of common stock and 100,000,000 shares of preferred stock. The shares of common stock and preferred

124

stock were authorized in an amount greater than that to be issued to provide our board of directors with as much flexibility as possible to effect, among other transactions, financings, acquisitions, stock dividends, stock splits and the exercise of employee stock options. However, these additional authorized shares may also be used by the board of directors consistent with its fiduciary duty to deter future attempts to gain control of Pacific Community Banking Group. The board of directors also has sole authority to determine the terms of any one or more series of preferred stock, including voting rights, conversion rates, and liquidation preferences. As a result of the ability to fix voting rights for a series of preferred stock, the board has the power, to the extent consistent with its fiduciary duties, to issue a series of preferred stock to persons friendly to management in order to attempt to block a tender offer, merger or other transaction by which a third party seeks control of Pacific Community Banking Group, and thereby assist members of management to retain their positions. Our board has no present plans for the issuance of additional shares, other than the issuance of shares of Company common stock upon exercise of stock options.

**SHAREHOLDER VOTE REQUIRED TO APPROVE BUSINESS COMBINATION WITH PRINCIPAL SHAREHOLDERS.** Our articles of incorporation require the approval of the holders of at least 66 2/3% of Pacific Community Banking Group's outstanding shares of voting stock to approve "Business Combinations" involving a "Related Person" except in cases where the proposed transaction has been approved in advance by a majority of those members of our board of directors who are unaffiliated with the Related Person and were directors prior to the time when the Related Person became a Related Person. The term "Related Person" is defined to include any individual, corporation, partnership or other entity, other than Pacific Community Banking Group or its subsidiary, which owns beneficially or controls, directly or indirectly, 10% or more of the outstanding shares of our voting stock or of an affiliate of such person or entity. This provision of our articles of incorporation applies to any "Business Combination," which is defined to include:

- any merger or consolidation of Pacific Community Banking Group with or into any Related Person;
  - any sale, lease, exchange, mortgage, transfer, or other disposition of 25% or more of the assets of Pacific Community Banking Group or a subsidiary of Pacific Community Banking Group to a Related Person;
  - any merger or consolidation of a Related Person with or into Pacific Community Banking Group or a subsidiary of Pacific Community Banking Group;
  - any sale, lease, exchange, transfer, or other disposition of 25% or more of the assets of a Related Person to Pacific Community Banking Group or a subsidiary of Pacific Community Banking Group;
  - the issuance of any securities of Pacific Community Banking Group or a subsidiary of Pacific Community Banking Group to a Related Person;
  - the acquisition by Pacific Community Banking Group or a subsidiary of Pacific Community Banking Group of any securities of a Related Person;
  - any reclassification of common stock of Pacific Community Banking Group or any recapitalization involving the common stock of Pacific Community Banking Group; or
- 125
- any agreement contract or other arrangement providing for any of the transactions described in the foregoing.

Under California law, absent this provision, business combinations, including mergers, consolidations and sales of substantially all of the assets of a corporation must, subject to exceptions, be approved by the vote of the holders of a majority of the outstanding shares of our common stock and any other affected class of stock. The increased shareholder vote required to approve a business combination may have the effect of foreclosing mergers and other business combinations which a majority of shareholders deem desirable and place the power to prevent such a merger or combination in the hands of a minority of shareholders.

**AMENDMENT OF ARTICLES OF INCORPORATION AND BYLAWS.** Amendments to our articles must be approved by a majority vote of its board of directors and also by a majority of the outstanding shares of its voting stock. An affirmative vote of at least 66 2/3% of the outstanding voting stock entitled to vote is required to amend or repeal provisions of the Articles of Incorporation, including the provision limiting voting rights, the provisions relating to approval of business combinations, the number and classification of directors, and amendment of Pacific Community Banking Group's bylaws and articles of incorporation. Pacific Community Banking Group's bylaws may be amended by its board of directors, or by a vote of 66 2/3% of the total votes eligible to be voted at a duly constituted meeting of shareholders.

SHAREHOLDER NOMINATIONS AND PROPOSALS. Our bylaws require a shareholder who intends to nominate a candidate for election to the board of directors to give at least 10 days notice after the mailing to the President of Pacific Community Banking Group. The articles of incorporation provide that a shareholder who desires to raise new business to provide information to Pacific Community Banking Group concerning the nature of the new business, the shareholder and the shareholder's interest in the business matter. Similarly, a shareholder wishing to nominate any person for election as a director must provide us with information concerning the nominee and the proposing shareholder.

PURPOSE AND TAKEOVER DEFENSIVE EFFECTS OF COMPANY'S ARTICLES OF INCORPORATION. Our board of directors believes that the provisions described above are prudent and will reduce our vulnerability to takeover attempts and similar transactions that have not been negotiated with and approved by its board of directors. The board of directors believes these provisions are in our best interest and in the best interest of Pacific Community Banking Group's shareholders. In the judgment of the board of directors, our board will be in the best position to determine the true value of Pacific Community Banking Group and to negotiate more effectively for what may be in the best interest of its shareholders. Accordingly, the board of directors believes that it is in the best interest of Pacific Community Banking Group and its shareholders to encourage potential acquirors to negotiate directly with the board of directors of Pacific Community Banking Group and that these provisions will encourage such negotiations and discourage hostile takeover attempts. It is also the view of the board of directors that these provisions should not discourage persons from proposing a merger or other transaction at a price reflective of the true value of Pacific Community Banking Group and which is in the best interest of all shareholders.

Attempts to acquire control of financial institutions have recently become increasingly common. Takeover attempts which have not been negotiated with and approved by the board of directors present to shareholders the risks of a takeover on terms which may be less

126

favorable than might otherwise be available. A transaction which is negotiated and approved by the board of directors, on the other hand, can be carefully planned and undertaken at an opportune time in order to obtain maximum value of Pacific Community Banking Group and its shareholders, with due consideration given to matters such as the management and business of the acquiring corporation and maximum strategic development of Pacific Community Banking Group's assets.

An unsolicited takeover proposal can seriously disrupt the business and management of a corporation and cause it to incur great expense. Although a tender offer or other takeover attempt may be made at a price substantially above the current market prices, such offers are sometimes made for less than all of the outstanding shares of a target company. As a result, shareholders may be presented with the alternative of partially liquidating their investment at a time that may be disadvantageous, or retaining their investment in an enterprise which is under different management and whose objectives may not be similar to those of the remaining shareholders. The concentration of control, which could result from a tender offer or other takeover attempt, could also deprive Pacific Community Banking Group's remaining shareholders of benefits of protective provisions of the Securities Exchange Act if the number of beneficial owners became less than the 300 thereby allowing for deregistration under that act.

Despite our belief as to the benefits to shareholders of these provisions of Pacific Community Banking Group's articles of incorporation, these provisions may also have the effect of discouraging a future takeover attempt which would not be approved by Pacific Community Banking Group's board, but pursuant to which shareholders may receive a substantial premium for their shares over then current market prices. As a result, shareholders who might desire to participate in such a transaction may not have any opportunity to do so. Such provisions will also render the removal of our board of directors and of management more difficult. Our board of directors, however, has concluded that the potential benefits outweigh the possible disadvantages.

Pursuant to applicable law, at any annual or special meeting of our shareholders, we may adopt additional charter provisions regarding the acquisition of our equity securities that would be permitted for a California business corporation. We do not presently intend to propose the adoption of further restrictions on the acquisition of our equity securities.

The cumulative effect of the restriction on acquisition of Pacific Community Banking Group contained in the articles of incorporation and bylaws, federal law and California law may be to discourage potential takeover attempts and perpetuate incumbent management, even though some of our shareholders may deem a potential acquisition to be in their best interest, or deem existing management not to be acting in their best interests.

TRANSFER AGENT AND REGISTRAR

SHARES ELIGIBLE FOR FUTURE SALE

Upon completion of this offering, Pacific Community Banking Group will have approximately \_\_\_\_\_ shares of common stock outstanding assuming no exercise of the underwriters' over-allotment option. Effective upon the consummation of this offering, assuming no exercise of outstanding options, Pacific Community Banking Group will have outstanding options to purchase approximately 470,000 shares of common stock and warrants to purchase approximately 1,308,000 shares of its common stock.

Of the common stock outstanding upon completion of this offering, the 3,750,000 shares of common stock sold in this offering and \_\_\_\_\_ shares held by former shareholders of The Bank of Hemet and Valley Bank will be freely tradable without restriction or further registration under the Securities Act, except for any shares purchased in this offering by "affiliates" of Pacific Community Banking Group, as that term is defined under the Securities Act and the Regulations promulgated thereunder. The \_\_\_\_\_ shares held by prior holders of Pacific Community Banking Group preferred and common stock, were sold by Pacific Community Banking Group in reliance on exemptions from the registration requirements of the Securities Act and are "restricted securities" within the meaning of Rule 144 under the Securities Act. The remaining \_\_\_\_\_ shares held by officers and directors of Pacific Community Banking Group and former officers, directors and principal shareholders of The Bank of Hemet and Valley Bank are "restricted securities" within the meaning of Rules 144 and Rule 145 under the Securities Act. Any shares of common stock issued upon the exercise of options or warrants currently held by any of such persons will also constitute restricted securities. \_\_\_\_\_ shares of common stock held by existing shareholders are subject to lock-up agreements with the Underwriter's representatives. Of the shares of common stock subject to lock-up agreements, approximately \_\_\_\_\_ shares may not be sold or transferred until 90 days after the date of this prospectus (the "Effective Date") and \_\_\_\_\_ shares may not be sold or transferred until 180 days after the Effective Date. None of the shares subject to lock-up agreements may be sold or transferred during the applicable lock-up period without the consent of the underwriters except for transfers pursuant to gifts or some partnership distributions and similar transfers in which the transferee enters into a substantially similar lock-up agreement. When the lock-up agreements expire, all of such locked-up shares will become eligible for sale subject to the provisions of Rules 144 or 701. The Underwriters may, in their sole discretion and at any time without notice, release all or any portion of the securities subject to these lock-up agreements.

In general, under Rule 144 as currently in effect, a person (or persons whose shares are aggregated), including an affiliate, who has beneficially owned restricted securities for a period of at least one year from the later of the date such restricted securities were acquired from Pacific Community Banking Group or the date they were acquired from an affiliate, is entitled to sell, within any three-month period commencing 90 days after the Effective Date, a number of shares that does not exceed the greater of 1% of the then outstanding shares of common stock (approximately \_\_\_\_\_ shares immediately after this offering) or the average weekly trading volume in the common stock during the four weeks preceding such sale. Sales under Rule 144 are also subject to provisions relating to the manner and notice of sale and the availability of current public information about Pacific Community Banking Group.

Further, under Rule 144(k), if a period of at least two years has elapsed between the later of the date restricted securities were acquired from Pacific Community Banking Group

and the date they were acquired from an affiliate of Pacific Community Banking Group, a holder of the restricted securities who is not an affiliate at the time of the sale and has not been an affiliate for at least three months prior to the sale would be entitled to sell the shares immediately after the Effective Date without regard to the volume and manner of sale limitations described above. Any employee, director or consultant to Pacific Community Banking Group who purchased his or her shares pursuant to a written compensation plan or contract is entitled to rely on the resale provisions of Rule 701, which permits non-Affiliates to sell their Rule 701 shares beginning 90 days after the Effective Date without having to comply with the volume limitations and other restrictions of Rule 144 holding period restrictions. As of the Effective Date,

there were no outstanding options to purchase shares which might be available for sale pursuant to Rule 701. Of the approximately 470,000 total shares issuable upon exercise of outstanding options, none are exercisable for the first year after the Effective Date. For information about the consequences of future sales of shares, please refer to "Risk Factors--Future sales of securities could diminish the interests of our shareholders" and "-- Substantial sales of our common stock could adversely affect our stock price."

Under Rule 145, persons who were affiliates of The Bank of Hemet and Valley Bank at the time of the acquisitions, but who have not been affiliates of Pacific Community Banking Group within three months of the time they sell their shares, will be restricted in selling shares during the first year after the acquisition. During the first year, those persons may sell no more within any three-month period than the greater of 1% of the then outstanding shares of common stock (approximately shares immediately after this offering) or the average weekly trading volume during the four weeks preceding such sale. Restrictions on manner of sale will also apply.

Prior to this offering, there has been no public market for the common stock of Pacific Community Banking Group, and any sale of substantial amounts of common stock in the open market, or the availability of shares for sale, may adversely affect the market price of the common stock and the ability of Pacific Community Banking Group to raise funds through equity offerings in the future.

As of the effective date of the registration statement of which this prospectus is a part, holders of shares of common stock will be entitled to registration rights with respect to their shares. For a description of these rights and information about the consequences of their existence, please refer to "Description of Capital Stock--Registration Rights."

129

UNDERWRITING

Subject to the terms and conditions set forth in an underwriting agreement between Sutro & Co. Incorporated, Friedman, Billings, Ramsey & Co., Inc., Wedbush Morgan Securities Inc., and Ragen MacKenzie Incorporated as Representatives of the several underwriters, Pacific Community Banking Group and the selling shareholders, the underwriters named below have severally agreed to purchase from Pacific Community Banking Group and the selling shareholders the aggregate number of shares of common stock set forth opposite each of their names:

<TABLE> <CAPTION> NAME	NUMBER OF SHARES
<S>	<C>
Sutro & Co. Incorporated.....	
Friedman, Billings, Ramsey & Co., Inc.....	
Wedbush Morgan Securities Inc.....	
Ragen MacKenzie Incorporated.....	
Total:.....	
</TABLE>	

The underwriting agreement provides that the obligations of the underwriters are subject to conditions precedent, including the absence of any material adverse change in Pacific Community Banking Group's business and the receipt of certificates, opinions and letters from Pacific Community Banking Group and its counsel and independent auditors and certificates, opinions and letters from officers of The Bank of Hemet and Valley Bank and their respective counsel and independent auditors. The nature of the underwriters' obligations is such that the underwriters are committed to purchase all shares of common stock offered hereby if any of such shares are purchased. The underwriting agreement also provides that the underwriters' legal counsel fees and costs, which the Representatives estimates at approximately \$225,000, shall be paid for by Pacific Community Banking Group. Sutro & Co. Incorporated estimates that it will incur approximately \$90,000 of these fees and costs in connection with advice relating to the acquisitions. In addition, the underwriting agreement provides that Pacific Community Banking Group will reimburse the underwriters for up to \$15,000 of out-of-pocket expenses incurred in this offering unless Pacific Community Banking Group consents to a higher amount.

Pacific Community Banking Group has also agreed to pay Sutro & Co. Incorporated an advisory fee of \$750,000 in consideration of Sutro & Co. Incorporated's financial advisory services in connection with the acquisitions of The Bank of Hemet and Valley Bank, conditioned upon completion of the offering, as well as approximately \$65,000 in fees relating to other services

provided in connection with the acquisitions.

The underwriters propose to offer the shares of common stock directly to the public at the public offering price set forth on the cover page of this prospectus and to dealers at such price less a concession not in excess of \$ \_\_\_\_\_ per share. The underwriters may allow, and such dealers may reallow, a concession not in excess of \$ \_\_\_\_\_ per share to other dealers. After the public offering of the shares, the underwriters may change this offering price and other selling terms. The underwriting discount for those shares sold by the Selling Shareholders will be paid for by Pacific Community Banking Group.

130

Prior to this offering, there has been no public market for the common stock. Accordingly, the initial public offering price will be determined by negotiations among the representatives of the underwriters, representatives of the Selling Shareholders and Pacific Community Banking Group. Among the factors which will be considered in such negotiations are the prevailing market conditions, the history of, and the prospects for, Pacific Community Banking Group and the banks and the industry in which they will compete, past and present operations of the banks, past and present earnings and prospects for future earnings, an assessment of management, the general condition of the securities market at the time of this offering and other factors deemed relevant.

Pacific Community Banking Group has granted to the underwriters an option, exercisable no later than 30 days after the date of this Prospectus, to purchase up to an aggregate of 555,000 additional shares of common stock from Pacific Community Banking Group at the public offering price, less the underwriting discount set forth on the cover page of this prospectus. To the extent that the underwriters exercise the option, the underwriters will have a firm commitment to purchase additional shares in approximately the same proportion that the number of shares of common stock to be purchased by each of them shown in the above table bears to the total number of shares of common stock offered in this prospectus. Under the terms of the option, Pacific Community Banking Group will be obligated to sell shares to the underwriters to the extent the option is exercised. The underwriters may exercise the option only to cover over-allotments made in connection with the sale of the shares of common stock offered in this prospectus.

The offering of the shares is made for delivery when, as and if accepted by the underwriters and subject to prior sale and to withdrawal, cancellation or modification of this offering without notice. The underwriters reserve the right to reject an order for the purchase of shares in whole or in part.

Pacific Community Banking Group and the selling shareholders have agreed to indemnify the underwriters against liabilities, including liabilities under the Securities Act, and to contribute to payments the underwriters may be required to make in respect thereof.

The executive officers, certain directors and certain other shareholders of Pacific Community Banking Group, The Bank of Hemet and Valley Bank, have agreed that they will not, without the prior written consent of Sutro & Co. Incorporated, offer, sell or otherwise dispose of any shares of common stock, options or warrants to acquire shares of common stock or securities exchangeable for or convertible into shares of common stock owned by them during either a 90-day or 180-day period following the effective date of this offering, except the following transfers:

- sales made in connection with this offering;
- the issuance of shares upon the exercise of options granted prior to the date hereof and the grant of additional options by Pacific Community Banking Group under its stock option plans;
- to his or her immediate family; or
- to a charitable organization.

131

Family members or charitable organizations that receive stock under the provisions described above must agree to be bound by the terms of lock-up agreement that bound the original holder.

In connection with this offering, the underwriters and other persons participating in this offering may engage in transactions that stabilize, maintain or otherwise affect the price of the common stock. Specifically, the underwriters may over-allot in connection with this offering, creating a short position in the common stock for their own account. To cover over-allotments or to stabilize the price of the common stock, the underwriters may bid for, and purchase, shares of the common stock in the open market. The underwriters may also impose a penalty bid whereby the underwriters may reclaim selling concessions allowed to other underwriters, if any, or dealers for distributing

the common stock in this offering, if the underwriters repurchase previously distributed common stock in transactions to cover their short position, in stabilization transactions or otherwise. Finally, the underwriters may bid for, and purchase, shares of the common stock in market making transactions. These activities may stabilize or maintain the market price of the common stock above market levels that may otherwise prevail. The underwriters are not required to engage in these activities, which may be effected on the Nasdaq Stock Market or otherwise, and may end any of these activities at any time.

The representatives have advised Pacific Community Banking Group that the underwriters do not intend to confirm sales to accounts over which they exercise discretionary authority.

EXPERTS

The financial statements for Pacific Community Banking Group and The Bank of Hemet included in this prospectus and elsewhere in the registration statement have been audited by Arthur Andersen LLP, independent public accountants, as indicated in their reports dated February 26, 1999 and January 27, 1999, respectively, with respect thereto, and are included herein in reliance upon the authority of said firm as experts in giving said reports.

The balance sheets of Valley Bank as of December 31, 1998 and 1997 and the related statements of income, changes in shareholders' equity and cash flows for each of the years in the three-year period ended December 31, 1998, and included in this Prospectus have been audited by McGladrey & Pullen, LLP, independent certified public accountants, incorporated by reference herein, upon the authority of said firm as experts in accounting and auditing.

LEGAL MATTERS

The validity of the common stock offered hereby will be passed upon by Morrison & Foerster LLP, Irvine, California. Matters regarding corporate formation will be passed upon for Pacific Community Banking Group by Knecht & Hansen, Newport Beach, California. Matters of concern to the underwriters in connection with this offering will be passed upon for the underwriters by Manatt Phelps & Phillips, LLP, Los Angeles, California. Mr. Loren Hansen of the firm Knecht & Hansen has purchased an aggregate of 100,000 shares of Series A Preferred Stock which will automatically convert into 8,064 shares of common stock upon the closing of this offering.

132

ADDITIONAL INFORMATION

Pacific Community Banking Group has filed with the Securities and Exchange Commission a registration statement on Form S-1 (together with all amendments and exhibits thereto, the "Registration Statement") under the Securities Act with respect to the shares of common stock offered hereby. This prospectus does not contain all of the information set forth in the Registration Statement, parts of which are omitted in accordance with the rules and regulations of the Commission. For further information with respect to Pacific Community Banking Group and the shares of common stock offered hereby, reference is made to the registration statement. Statements contained in this Prospectus as to the contents of any contract or other document are not necessarily complete, and in each instance reference is made to the copy of such contract or other document filed as an exhibit to the registration statement, each such statement being qualified in all respects by such reference. Copies of such materials may be examined without charge at, or obtained upon payment of prescribed fees from, the Public Reference Section of the Commission at Room 1024 Judiciary Plaza, 450 Fifth Street, N.W., Washington, D.C. 20549 (telephone 202- 942-8090), and at the Commission's regional offices located at 500 West Madison Street, Suite 1400, Chicago, Illinois 60661 and at 7 World Trade Center, 13th Floor, New York New York 10048. The Commission maintains a World Wide Website that contains reports, proxy and information statements and other information regarding registrants that file electronically with the Commission. The address of the site is <http://www.sec.gov>. Reports, proxy statements and other information concerning Pacific Community Banking Group may also be inspected at the National Association of Securities Dealers, Inc. at 1735 K Street, N.W., Washington D.C. 20006.

133

INDEX TO FINANCIAL STATEMENTS

<TABLE>  
<CAPTION>

<S>  
Pacific Community Banking Group

PAGE NO.  
-----  
<C>

Report of Arthur Andersen LLP, Independent Public Accountants..... F-2

Balance Sheets--December 31, 1998 and 1997 and March 31, 1999.....	F-3
Statements of Operations.....	F-4
Statements of Shareholders' Equity.....	F-5
Statements of Cash Flow.....	F-6
Notes to Financial Statements.....	F-7

The Bank of Hemet

Report of Arthur Andersen LLP, Independent Public Accountants.....	F-11
Consolidated Balance Sheets--December 31, 1998 and 1997 and March 31, 1999.....	F-12
Consolidated Statements of Operations.....	F-13
Consolidated Statements of Changes in Stockholders' Equity.....	F-14
Consolidated Statements of Cash Flow.....	F-15
Notes to Consolidated Financial Statements.....	F-16

Valley Bank

Report of McGladrey & Pullen, LLP, Independent Auditors.....	F-35
Balance Sheets--December 31, 1998 and 1997 and March 31, 1999.....	F-36
Statements of Operations.....	F-37
Statements of Stockholders' Equity.....	F-38
Statements of Cash Flows.....	F-39
Notes to Financial Statements.....	F-40

</TABLE>

F-1

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Board of Directors of  
Pacific Community Banking Group:

We have audited the accompanying balance sheets of PACIFIC COMMUNITY BANKING GROUP (a California corporation) as of December 31, 1998 and 1997, and the related statements of operations, shareholders' equity and cash flows for the year ended December 31, 1998, and for the period from inception (October 17, 1997) to December 31, 1997. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Pacific Community Banking Group as of December 31, 1998 and 1997, and the results of its operations and its cash flows for the year ended December 31, 1998 and the period from inception (October 17, 1997) to December 31, 1997 in conformity with generally accepted accounting principles.

ARTHUR ANDERSEN LLP

Orange County, California  
February 26, 1999

F-2

PACIFIC COMMUNITY BANKING GROUP  
BALANCE SHEETS--DECEMBER 31, 1998 AND 1997 AND MARCH 31, 1999

<TABLE>  
<CAPTION>

	MARCH 31, 1999	1998	1997
	-----	-----	-----
	(UNAUDITED)		
<S>	<C>	<C>	<C>
ASSETS			
CURRENT ASSETS:			
Cash.....	\$ 113,294	\$ 395,948	\$ 170,131
Prepaid expenses.....	--	1,333	--
Capitalized acquisition and offering costs.....	610,218	198,127	26,814
	-----	-----	-----
Total current assets.....	723,512	595,408	196,945
	-----	-----	-----
EQUIPMENT AND FURNITURE, at cost.....	7,096	7,096	--



Less--accumulated depreciation.....	1,944	1,458	--
	5,152	5,638	--
	\$ 728,664	\$ 601,046	\$ 196,945
LIABILITIES AND SHAREHOLDERS' EQUITY			
CURRENT LIABILITIES:			
Accounts payable.....	\$ 174,097	\$ 94,429	\$ 54,112
Refundable common stock subscriptions.....	--	--	85,000
Total current liabilities.....	174,097	94,429	139,112
COMMITMENTS AND CONTINGENCIES (Note 5)			
SHAREHOLDERS' EQUITY:			
Preferred stock, no par value:			
Authorized--100,000,000 shares			
Series A: 1,085,000 shares authorized, 1,085,000 outstanding at March 31, 1999, 0 at December 31, 1998 and 1997, net of unpaid subscriptions.....	923,840	--	--
Series B: 375,000 shares authorized, 375,000 outstanding at March 31, 1999, 0 at December 31, 1998 and 1997, net of unpaid subscriptions.....	360,000	--	--
Common stock, no par value:			
Authorized--100,000,000 shares			
Issued and outstanding--10,000 shares.....	2,500	2,500	2,500
Common stock subscriptions.....	--	1,305,000	680,000
Common stock subscriptions receivable.....	--	(205,764)	(542,990)
Accumulated deficit.....	(731,773)	(595,119)	(81,677)
Total shareholders' equity.....	554,567	506,617	57,833
	\$ 728,664	\$ 601,046	\$ 196,945

</TABLE>

The accompanying notes are an integral part of these balance sheets.

F-3

PACIFIC COMMUNITY BANKING GROUP  
STATEMENTS OF OPERATIONS

<TABLE>  
<CAPTION>

	THREE MONTHS ENDED		YEAR ENDED	INCEPTION
	MARCH 31, 1999	MARCH 31, 1998	DECEMBER 31, 1998	(OCTOBER 17, 1997) TO DECEMBER 31, 1997
	(UNAUDITED)			
<S>	<C>	<C>	<C>	<C>
REVENUES.....	\$ --	\$ --	\$ --	\$ --
GENERAL AND ADMINISTRATIVE EXPENSES.....	140,222	77,141	525,568	82,477
Loss from operations.....	140,222	77,141	525,568	82,477
INTEREST INCOME.....	3,568	--	11,326	--
Net loss before taxes.....	136,654	77,141	514,242	82,477
PROVISION FOR INCOME TAXES.....	--	--	800	800
Net loss.....	\$ 136,654	\$ 77,141	\$ 513,442	\$ 81,677
Basic and diluted loss per share.....	\$ 13.66	\$ 7.71	\$ 51.34	\$ 8.17
Weighted average shares outstanding.....	10,000	10,000	10,000	10,000

</TABLE>

The accompanying notes are an integral part of these statements.

F-4

PACIFIC COMMUNITY BANKING GROUP  
STATEMENTS OF SHAREHOLDERS' EQUITY

<TABLE>  
<CAPTION>

SERIES A

SERIES B

	PREFERRED STOCK		PREFERRED STOCK		COMMON STOCK		COMMON STOCK
	SHARES	AMOUNT	SHARES	AMOUNT	SHARES	AMOUNT	SUBSCRIPTIONS
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
BALANCE, October 17, 1997, (inception).....	--	\$ --	--	\$ --	--	\$ --	\$ --
Common stock issuance.....	--	--	--	--	10,000	2,500	--
Common stock subscriptions.....	--	--	--	--	--	--	680,000
Net loss.....	--	--	--	--	--	--	--
BALANCE, December 31, 1997.....	--	--	--	--	10,000	2,500	680,000
Common stock subscriptions.....	--	--	--	--	--	--	625,000
Net loss.....	--	--	--	--	--	--	--
BALANCE, December 31, 1998.....	--	--	--	--	10,000	2,500	1,305,000
Common stock subscriptions.....	--	--	--	--	--	--	155,000
Conversion of subscriptions to preferred stock (Note 7).....	1,085,000	923,840	375,000	360,000	--	--	(1,460,000)
Net loss.....	--	--	--	--	--	--	--
BALANCE, March 31, 1999 (unaudited).....	1,085,000	\$ 923,840	375,000	\$ 360,000	10,000	\$ 2,500	\$ --

<CAPTION>

	COMMON STOCK		
	SUBSCRIPTIONS RECEIVABLE	ACCUMULATED DEFICIT	TOTAL EQUITY
<S>	<C>	<C>	<C>
BALANCE, October 17, 1997, (inception).....	\$ --	\$ --	\$ --
Common stock issuance.....	--	--	2,500
Common stock subscriptions.....	(542,990)	--	137,010
Net loss.....	--	(81,677)	(81,677)
BALANCE, December 31, 1997.....	(542,990)	(81,677)	57,833
Common stock subscriptions.....	337,226	--	962,226
Net loss.....	--	(513,442)	(513,442)
BALANCE, December 31, 1998.....	(205,764)	(595,119)	506,617
Common stock subscriptions.....	29,604	--	184,604
Conversion of subscriptions to preferred stock (Note 7).....	176,160	--	--
Net loss.....	--	(136,654)	(136,654)
BALANCE, March 31, 1999 (unaudited).....	\$ --	\$ (731,773)	\$ 554,567

</TABLE>

The accompanying notes are an integral part of these statements.

F-5

PACIFIC COMMUNITY BANKING GROUP  
STATEMENTS OF CASH FLOWS

<TABLE>

<CAPTION>

	THREE MONTHS ENDED		YEAR ENDED	INCEPTION
	MARCH 31, 1999	MARCH 31, 1998	DECEMBER 31, 1998	(OCTOBER 17, 1997) TO DECEMBER 31, 1997
<S>	<C>	<C>	<C>	<C>
CASH FLOWS FROM OPERATING ACTIVITIES:				
Net loss.....	\$ (136,654)	\$ (77,141)	\$ (513,442)	\$ (81,677)
Adjustments to reconcile net loss to net cash used in operating activities--				
Depreciation and amortization.....	486	153	1,458	--
Expenses recorded on issuance of stock subscriptions in exchange for services.....	--	10,000	10,000	52,011
Changes in assets and liabilities:				
Increase in capitalized acquisition and offering costs.....	(287,091)	(37,289)	(171,313)	(26,814)
Increase (decrease) in prepaid expenses.....	1,333	--	(1,333)	--

Increase (decrease) in accounts payable.....	(45,332)	(14,909)	40,317	54,112
Net cash used in operating activities.....	(467,258)	(119,186)	(634,313)	(2,368)
CASH FLOWS FROM INVESTING ACTIVITIES:				
Purchases of equipment and furniture.....	--	(5,214)	(7,096)	--
Net cash used in investing activities.....	--	(5,214)	(7,096)	--
CASH FLOWS FROM FINANCING ACTIVITIES:				
Proceeds from the issuance of common stock, common stock subscriptions, and refundable common stock subscriptions.....	184,604	367,401	867,226	172,499
Net cash provided by financing activities....	184,604	367,401	867,226	172,499
NET INCREASE (DECREASE) IN CASH.....	(282,654)	243,001	225,817	170,131
CASH, beginning of year.....	395,948	170,131	170,131	--
CASH, end of year.....	\$ 113,294	\$ 413,132	\$ 395,948	\$ 170,131

</TABLE>

SUPPLEMENTAL DISCLOSURES OF NON CASH FINANCING ACTIVITIES:

During 1997, common stock subscriptions in the amount of \$52,011 were issued to an investor in exchange for payment of certain expenses.

During 1998, common stock subscriptions in the amount of \$10,000 were issued to a third party in exchange for services.

The accompanying notes are an integral part of these statements.

F-6

PACIFIC COMMUNITY BANKING GROUP

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 1998 AND 1997

1. COMPANY BACKGROUND

Pacific Community Banking Group (the Company), a California corporation, was formed on October 17, 1997, for the purpose of acquiring community banking organizations in the Southern California region. The Company has had no revenues to date.

2. ACQUISITION AGREEMENTS

During 1998, the Company entered into definitive agreements for the acquisition of The Bank of Hemet ("Hemet") and Valley Bank ("Valley"), which were amended subsequently during 1999. The agreements are contingent upon the completion of an initial public offering ("IPO"). The agreements provide for the exchange of all of the outstanding stock of Hemet and Valley for common stock and for warrants to purchase common stock of the Company. The shareholders of Hemet will receive 3.4 shares of the Company's common stock and one warrant in exchange for each share held of Hemet common stock. The Valley shareholders will receive two-thirds of a share of Company common stock for each share held of Valley common stock. Additionally, the Valley shareholders will receive one warrant for the purchase of Company common stock for every three shares held of Valley common stock. The Hemet and Valley warrants will be exercisable at 122 percent of the IPO price, and have a contractual life of ten years. There can be no assurance that the Company's proposed public offering will be successful and that these acquisitions will be completed.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a. 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 at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

b. EQUIPMENT AND FURNITURE

The Company provides for depreciation based on the estimated useful lives of depreciable assets using the straight-line method. Estimated useful

lives are as follows:

<TABLE>	
<S>	<C>
Computers and office equipment.....	3 years
Furniture and fixtures.....	7 years
</TABLE>	

Property additions are stated at acquisition cost. Upon retirement or disposal of depreciable assets, the cost and related accumulated depreciation are removed from the accounts and the resulting gain or loss is reflected in operations.

F-7

PACIFIC COMMUNITY BANKING GROUP

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

DECEMBER 31, 1998 AND 1997

c. CAPITALIZED ACQUISITION AND OFFERING COSTS

Certain legal, accounting and underwriting fees incurred in connection with a proposed acquisition of certain businesses have been capitalized as of December 31, 1997. During 1998, the Company expensed the balance of these costs. In addition, the Company has capitalized costs related to its planned IPO. Capitalized offering costs will be recorded as a reduction of the proceeds received in the IPO or will be expensed should the IPO not be consummated. Capitalized offering costs are approximately \$198,000 as of December 31, 1998.

d. INCOME TAXES

The Company accounts for income taxes using the asset and liability method as prescribed by Statement of Financial Accounting Standards ("SFAS") No. 109, "Accounting for Income Taxes." Under the asset and liability method, deferred income tax assets and liabilities are determined based on the differences between the financial reporting and tax bases of assets and liabilities and are measured using the currently enacted tax rates and laws.

e. EARNINGS PER SHARE

The Company accounts for earnings per share in accordance with SFAS No. 128, "Earnings Per Share." This Statement requires the presentation of both basic and diluted net income per share for financial statement purposes. Basic net income per share is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding. Diluted net income per share includes the effect of potential common shares, including dilutive stock options using the treasury stock method. For the year ended December 31, 1998 and the period ended December 31, 1997, potential common shares were excluded from the calculation of diluted net income per share as their impact would be anti-dilutive.

f. UNAUDITED INTERIM INFORMATION

The accompanying unaudited financial statements give effect to all adjustments (which are normal recurring accruals) necessary in the opinion of management to present fairly the financial statements for the interim periods presented. The unaudited financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission and do not include all the information and footnotes required by generally accepted accounting principles for complete financial statements and may be subject to year-end adjustments, which, in the opinion of management, are necessary for a fair statement of the results of the interim periods.

4. INCOME TAXES

No provision for federal income taxes has been recorded as the Company incurred net operating losses since inception. At December 31, 1998, the Company had

F-8

PACIFIC COMMUNITY BANKING GROUP

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

DECEMBER 31, 1998 AND 1997

approximately \$595,000 and \$297,000 of federal and state net operating

loss carryforwards, respectively, available to offset future taxable income; which expire through 2017. Under the Tax Reform Act of 1986, the benefits from net operating losses carried forward may be impaired or limited in certain circumstances. Events which may cause limitations in the amount of net operating losses that the Company may utilize in any one year include, but are not limited to, a cumulative ownership change of more than 50 percent over a three year period.

Deferred tax assets totaling approximately \$238,000 and \$33,000 at December 31, 1998 and 1997, respectively, consist primarily of the tax effect of net operating loss carryforwards. The Company has provided a full valuation allowance against the deferred tax assets due to uncertainty regarding the Company's ability to generate sufficient income in future periods for such assets to be realized.

5. COMMITMENTS AND CONTINGENCIES

LEASES

The Company occupies its office premises under a noncancellable lease agreement which expires in June 1999. At December 31, 1998, future minimum lease commitments are as follows:

<TABLE>	
<S>	<C>
Year ending December 31:	
1999.....	\$ 11,520
Thereafter.....	--
	-----
Total future minimum lease payments.....	\$ 11,520
	-----
	-----

</TABLE>

Rental expense for the year ended December 31, 1998 and for the period from inception to December 31, 1997 was approximately \$32,000 and \$7,000, respectively.

EMPLOYMENT AND CONSULTING AGREEMENTS

The Company entered into a five-year, four-month employment agreement with its Chief Executive Officer beginning on September 1, 1997. The agreement provides for an annual base salary that is adjusted for the Consumer Price Index, normal employee benefits, and an annual bonus at the discretion of the Board of Directors. The agreement also entitles the officer to 250,000 ten-year incentive stock options at an exercise price equal to the fair market value of the Company's common stock at the date of issuance, which would be issued after the closing of the IPO. Additionally, the agreement contains an income continuation provision, which will provide for payments of \$60,000 per year for fifteen years, beginning at the employee's retirement date. This provision could take effect at the successful closing of the Company's first acquisition or merger. Upon implementation of this provision, the Company will accrue a liability for the present value of the amounts to ultimately be

PACIFIC COMMUNITY BANKING GROUP

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

DECEMBER 31, 1998 AND 1997

distributed. However, the employee has invoked a waiver clause within the agreement, and thus has elected to defer the implementation of the income continuation provision until such time as the Company can support such provision.

On July 1, 1998, the Company entered into an agreement with a consultant to review certain loans being made by banks with which the Company has entered into definitive purchase agreements (Please refer to Note 2). The agreement, as amended, calls for the payment of a monthly retainer of \$3,500 per month from July 1, 1998 through May 15, 1999, as well as reimbursement for all out-of-pocket business expenses. Payments made under this agreement have been recorded in capitalized acquisition and offering costs in the accompanying financial statements.

6. COMMON STOCK SUBSCRIPTIONS

The Company has entered into common stock subscription agreements ("the Agreements") with various investors who have contributed cash or services to the Company. The Agreements provide for the conversion of funds invested into shares of common stock of the Company. The conversion into common stock would be at a price equal to eighty percent of the IPO

price, and the conversion will occur only under certain conditions, including the successful acquisition of a financial institution and the closing of an IPO. Under the terms of the Agreements, the funds invested could only be disbursed by the Company under certain conditions, which included the signing of a definitive acquisition agreement with a financial institution. As of December 31, 1997, under the terms of the Agreements, fifty percent of the invested funds were disburseable. The remaining fifty percent of invested funds is reflected as a liability in the accompanying financial statements. As of December 31, 1998, the conditions for full disbursement of invested funds had been met.

As of the respective balance sheet dates, the total value of Agreements that have been signed is included in common stock subscriptions in the accompanying financial statements. The portion of the Agreements that has not been paid is recorded as a subscription receivable, an offset to the common stock subscriptions account.

7. SUBSEQUENT EVENTS (UNAUDITED)

During March 1999, the Company amended its common stock subscription agreements. Funds that have been invested in the Company, which at March 31, 1999 totalled \$1,283,840, will be exchanged for one share of preferred stock for every dollar invested. Each share of preferred stock will automatically convert into shares of common stock upon the closing of the IPO. Initial founding investors will receive Series A Preferred Stock for all contributions, while subsequent investors will receive Series B Preferred Stock for their contributions. Series A Preferred Stock shall convert to common stock at a per share price of eighty percent of the IPO price per share. Series B Preferred Stock shall convert at a per share price of eighty-five percent of the IPO price per share.

F-10

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Shareholders and

Board of Directors of The Bank of Hemet:

We have audited the accompanying consolidated balance sheets of THE BANK OF HEMET (a California corporation) and subsidiaries as of December 31, 1998 and 1997, and the related consolidated statements of operations, changes in stockholders' equity and cash flows for each of the three years in the period ended December 31, 1998. These consolidated financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of The Bank of Hemet and subsidiaries as of December 31, 1998 and 1997, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1998 in conformity with generally accepted accounting principles.

ARTHUR ANDERSEN LLP

Orange County, California  
January 27, 1999

F-11

THE BANK OF HEMET AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

DECEMBER 31, 1998 AND 1997 AND MARCH 31, 1999

<TABLE>  
<CAPTION>

MARCH 31, 1999	-----	1998	-----	1997	-----
(UNAUDITED)					

<S>	ASSETS	<C>	<C>	<C>
CASH AND DUE FROM BANKS.....	\$ 5,892,000	\$ 6,496,000	\$ 6,521,000	
FEDERAL FUNDS SOLD.....	10,000,000	10,500,000	13,000,000	
Total Cash and Cash Equivalents.....	15,892,000	16,996,000	19,521,000	
INVESTMENT SECURITIES HELD TO MATURITY				
Market values of \$24,884,000 in 1998 and \$24,842,000 in 1997, respectively.....	24,892,000	24,882,000	24,833,000	
LOANS AND LEASES.....	209,503,000	207,802,000	192,287,000	
ALLOWANCE FOR LOAN AND LEASE LOSSES.....	(2,230,000)	(2,232,000)	(2,116,000)	
Loans and Leases, net.....	207,273,000	205,570,000	190,171,000	
PREMISES AND EQUIPMENT, net.....	1,613,000	1,541,000	1,637,000	
ACCRUED INTEREST RECEIVABLE.....	1,285,000	1,140,000	1,921,000	
OTHER REAL ESTATE OWNED.....	83,000	77,000	779,000	
OTHER ASSETS.....	2,579,000	2,671,000	2,461,000	
	\$253,617,000	\$ 252,877,000	\$ 241,323,000	

LIABILITIES AND STOCKHOLDERS' EQUITY

DEPOSITS				
Noninterest bearing demand deposits.....	\$ 33,664,000	\$ 33,975,000	\$ 29,307,000	
Savings and interest-bearing demand deposits.....	67,962,000	67,720,000	59,702,000	
Money market deposits.....	3,523,000	3,669,000	4,251,000	
Time deposits of \$100,000 or more.....	8,659,000	8,141,000	9,149,000	
Time deposits less than \$100,000.....	117,057,000	116,880,000	116,802,000	
Total Deposits.....	230,865,000	230,385,000	219,211,000	
ACCRUED INTEREST PAYABLE AND OTHER LIABILITIES.....	1,548,000	1,468,000	1,884,000	
	232,413,000	231,853,000	221,095,000	
COMMITMENTS AND CONTINGENCIES (Note 6)				
STOCKHOLDERS' EQUITY				
Common stock, no par value--Authorized--20,000,000 shares--Issued and outstanding--844,252.....	3,666,000	3,666,000	3,666,000	
Retained earnings.....	17,538,000	17,358,000	16,562,000	
Total Stockholders' Equity.....	21,204,000	21,024,000	20,228,000	
	\$253,617,000	\$ 252,877,000	\$ 241,323,000	

</TABLE>

The accompanying notes are an integral part of these consolidated balance sheets.

F-12

THE BANK OF HEMET AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE YEARS ENDED DECEMBER 31, 1998, 1997 AND 1996

AND THE THREE MONTHS ENDED MARCH 31, 1999 AND 1998

<TABLE>

<CAPTION>

<S>	THREE MONTHS ENDED				
	MARCH 31, 1999	MARCH 31, 1998	1998	1997	1996
	(UNAUDITED)				
<S>	<C>	<C>	<C>	<C>	<C>
INTEREST INCOME					
Loans, including fees.....	\$ 4,253,000	\$ 4,308,000	\$ 17,102,000	\$ 16,795,000	\$ 17,202,000
Investment securities.....	322,000	385,000	1,610,000	1,633,000	1,416,000
Federal funds sold.....	144,000	194,000	704,000	563,000	509,000
Total Interest Income.....	4,719,000	4,887,000	19,416,000	18,991,000	19,127,000

INTEREST EXPENSE					
Transaction and savings deposits.....	544,000	532,000	2,216,000	2,228,000	2,029,000
Time deposits of \$100,000 or more.....	104,000	126,000	501,000	489,000	891,000
Time deposits less than \$100,000.....	1,487,000	1,658,000	6,468,000	6,214,000	5,903,000
Other borrowings.....	0	0	0	15,000	0
Total Interest Expense.....	2,135,000	2,316,000	9,185,000	8,946,000	8,823,000
Net Interest Income.....	2,584,000	2,571,000	10,231,000	10,045,000	10,304,000
PROVISION FOR LOAN AND LEASE LOSSES.....	0	0	0	250,000	988,000
Net Interest Income after Provision for Loan and Lease Losses.....	2,584,000	2,571,000	10,231,000	9,795,000	9,316,000
NONINTEREST INCOME					
Fees and service charges on deposits.....	117,000	129,000	518,000	554,000	588,000
Other charges and fees.....	30,000	26,000	118,000	149,000	205,000
Other income.....	237,000	150,000	727,000	501,000	455,000
Total Noninterest Income.....	384,000	305,000	1,363,000	1,204,000	1,248,000
NONINTEREST EXPENSE					
Salaries and employee benefits.....	1,037,000	933,000	3,735,000	3,462,000	3,640,000
Premises and equipment.....	247,000	266,000	1,066,000	987,000	1,008,000
Other real estate owned, net.....	(3,000)	11,000	(101,000)	(187,000)	1,237,000
Other expenses.....	520,000	499,000	2,036,000	1,938,000	2,297,000
Total Noninterest Expense.....	1,801,000	1,709,000	6,736,000	6,200,000	8,182,000
Income before Provision for Income Taxes.....	1,167,000	1,167,000	4,858,000	4,799,000	2,382,000
PROVISION FOR INCOME TAXES.....	481,000	488,000	2,035,000	1,997,000	1,009,000
Net Income.....	\$ 686,000	\$ 679,000	\$ 2,823,000	\$ 2,802,000	\$ 1,373,000
EARNINGS PER SHARE					
Basic Earnings Per Share.....	\$ 0.81	\$ 0.80	\$ 3.34	\$ 3.25	\$ 1.53
Diluted Earnings Per Share.....	\$ 0.79	\$ 0.78	\$ 3.23	\$ 3.15	\$ 1.53

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

F-13

THE BANK OF HEMET AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

FOR THE YEARS ENDED DECEMBER 31, 1998, 1997 AND 1996

	COMMON STOCK		RETAINED EARNINGS
	SHARES	AMOUNT	
BALANCE, December 31, 1995.....	828,395	\$ 4,358,000	\$ 14,721,000
Exercise of stock options, including tax benefit.....	59,970	559,000	--
Amendment to preferred stock conversion (Note 9).....	6,536	147,000	(147,000)
Common stock cash dividend at \$1.00 per share.....	--	--	(882,000)
Supplemental cash dividend at \$0.19 per share (Note 9).....	--	--	(26,000)
Net income for the year.....	--	--	1,373,000
BALANCE, December 31, 1996.....	894,901	5,064,000	15,039,000
Repurchased shares.....	(50,649)	(1,398,000)	--
Common stock cash dividend at \$1.50 per share.....	--	--	(1,279,000)
Net income for the year.....	--	--	2,802,000
BALANCE, December 31, 1997.....	844,252	3,666,000	16,562,000
Common stock cash dividend at \$2.40 per share.....	--	--	(2,027,000)
Net income for the year.....	--	--	2,823,000



BALANCE, December 31, 1998.....	844,252	3,666,000	17,358,000
Common stock cash dividend at \$0.60 per share.....	--	--	(506,000)
Net income for the period.....	--	--	686,000
BALANCE, March 31, 1999 (unaudited).....	844,252	\$ 3,666,000	\$ 17,538,000

</TABLE>

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

F-14

THE BANK OF HEMET AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED DECEMBER 31, 1998, 1997 AND 1996

AND THE THREE MONTHS ENDED MARCH 31, 1999 AND 1998

<TABLE>

<CAPTION>

	THREE MONTHS ENDED		1998	1997	1996
	MARCH 31, 1999	MARCH 31, 1998			
	(UNAUDITED) <C>	(UNAUDITED) <C>	<C>	<C>	<C>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>					
Net income.....	\$ 686,000	\$ 679,000	\$ 2,823,000	\$ 2,802,000	\$ 1,373,000
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:					
Depreciation and amortization.....	70,000	74,000	299,000	259,000	287,000
Provision for possible loan and lease losses.....	0	0	0	250,000	988,000
Deferred income tax (benefit).....	120,000	328,000	199,000	513,000	(407,000)
Loss (gain) on sale and write-down of other real estate owned.....	(3,000)	(21,000)	(162,000)	(310,000)	936,000
Accretion of discount on investments.....	(1,000)	(22,000)	(36,000)	(259,000)	(182,000)
Decrease (increase) in accrued interest receivable.....	(145,000)	682,000	781,000	1,000	(539,000)
Increase in other assets.....	(27,000)	(135,000)	(409,000)	(304,000)	(43,000)
Increase (decrease) in accrued interest payable and other liabilities.....	81,000	(291,000)	(417,000)	(2,000)	435,000
Net Cash Provided by Operating Activities.....	781,000	1,294,000	3,078,000	2,950,000	2,848,000
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>					
Proceeds from maturities of investment securities.....	15,982,000	20,000,000	101,130,000	32,000,000	20,000,000
Purchases of investment securities.....	(15,993,000)	(20,276,000)	(101,142,000)	(31,794,000)	(22,037,000)
Net increase in loans and leases.....	(1,787,000)	(3,946,000)	(16,125,000)	(6,406,000)	(3,453,000)
Purchases of premises and equipment.....	(140,000)	(63,000)	(203,000)	(373,000)	(162,000)
Proceeds from sales of other real estate owned....	80,000	243,000	1,589,000	2,896,000	1,640,000
Net Cash Used in Investing Activities.....	(1,858,000)	(4,042,000)	(14,751,000)	(3,677,000)	(4,012,000)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>					
Net increase (decrease) in demand, savings, and money market deposits.....	(215,000)	2,864,000	12,104,000	1,699,000	10,676,000
Net increase (decrease) in time deposits.....	694,000	441,000	(929,000)	5,244,000	(5,834,000)
Stock options exercised including tax benefit....	0	0	0	0	559,000
Cash dividends paid.....	(506,000)	(506,000)	(2,027,000)	(1,279,000)	(908,000)
Cash paid for Tender Offer, including expenses....	0	0	0	(1,398,000)	0
Net Cash Provided by Financing Activities.....	(27,000)	2,799,000	9,148,000	4,266,000	4,493,000
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS.....</b>					
	(1,104,000)	51,000	(2,525,000)	3,539,000	3,329,000
CASH AND CASH EQUIVALENTS, Beginning of Year.....	16,996,000	19,521,000	19,521,000	15,982,000	12,653,000
CASH AND CASH EQUIVALENTS, End of Year.....	\$ 15,892,000	\$ 19,572,000	\$ 16,996,000	\$ 19,521,000	\$ 15,982,000

SUPPLEMENTAL INFORMATION

Interest paid.....	\$ 2,147,000	\$ 2,319,000	\$ 9,212,000	\$ 8,919,000	\$ 8,853,000
Income taxes paid.....	180,000	180,000	\$ 2,105,000	\$ 1,160,000	\$ 995,000
Loans to Facilitate Sale of Other Real Estate					
Owned.....	0	0	\$ 37,000	\$ 949,000	\$ 398,000
Transfer from Loans to Other Real Estate Owned..	83,000	2,000	\$ 726,000	\$ 1,185,000	\$ 847,000

</TABLE>

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

F-15

THE BANK OF HEMET AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 1998, 1997 AND 1996

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. PRINCIPLES OF CONSOLIDATION AND NATURE OF OPERATIONS

The consolidated financial statements include the accounts of The Bank of Hemet, and its primary wholly owned subsidiary, BankLink Corporation (BankLink) (collectively referred to as "the Bank"). BankLink is a provider of data processing services for banks. The Bank operates five branches in communities located in the Inland Empire area of Southern California. The Bank's primary source of revenue is providing commercial and industrial income-producing real estate loans to small and middle-market businesses and individuals. The Bank offers a full range of commercial banking services. All significant intercompany accounts and transactions have been eliminated in the consolidated financial statements.

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 assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

B. INVESTMENT SECURITIES HELD TO MATURITY

Securities are classified as held to maturity and are carried at cost, decreased by the amortization of premiums and increased by the accretion of discounts, as applicable. Realized gains or losses recognized on sales of securities are based upon the adjusted cost and computed on the specific identification method and are booked in other income or other expense, as applicable. The Bank's intention is to hold its investment securities to maturity, and does not anticipate selling any portion of the investment securities portfolio for liquidity or other purposes.

C. LOANS AND LEASES

Loans and leases are stated at the amount of unpaid principal, reduced by an allowance for loan and lease losses and deferred net loan origination fees. Interest on loans is recognized over the terms of the loans and is calculated on principal amounts outstanding. Loan origination fees, offset by certain direct loan origination costs, are deferred and recognized over the contractual life of the loan as a yield adjustment. As unearned revenue, the net unrecognized fees and costs are reported as reductions of the loan balance.

Accrual of interest on loans and leases is discontinued when management believes, after considering economic and business conditions, and collection efforts, that the borrower's financial condition is such that collection of interest is doubtful. Income is subsequently recognized only to the extent cash payments are received until, in management's judgment, the borrower's ability to make periodic interest and principal payments is no longer doubtful, in which case the credit is returned to accrual status.

F-16

THE BANK OF HEMET AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

DECEMBER 31, 1998, 1997 AND 1996

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The Bank measures impairment on a loan by loan basis using either the present value of expected future cash flows discounted at the loan's effective interest rate, or the fair value of the collateral if the loan is collateral dependent. The Bank excludes from its impairment calculations smaller balance, homogeneous loans such as consumer installment loans and lines of credit, and

direct finance leases. In determining whether a loan is impaired or not, the Bank applies its normal loan review procedures. Loans for which an insignificant delay, i.e., less than 90 days past due, or an insignificant shortfall in the amount of payments is anticipated, but the Bank expects to collect all amounts due, are not considered for impairment.

#### D. ALLOWANCE FOR LOAN AND LEASE LOSSES

The allowance for loan and lease losses is maintained at a level considered adequate to provide for losses that can be reasonably anticipated. Management makes periodic credit reviews of the loan and lease portfolio and considers current economic conditions, historical loan loss experience, assessments of problem credits and other factors in determining the adequacy of the allowance. The allowance is based on estimates and ultimate losses may vary from the current estimates. These estimates are reviewed periodically and, as adjustments become necessary, they are reported in earnings in the periods in which they become known. The allowance is increased by provisions charged to operating expense and reduced by net charge-offs.

#### E. PREMISES AND EQUIPMENT

The Bank's buildings, furniture, equipment and leasehold improvements are stated at cost less accumulated depreciation and amortization, which is charged to expense on a straight-line basis over the estimated useful lives of the assets or, in the case of leasehold improvements, over the life of the leases, whichever is shorter. Maintenance and repairs are charged directly to expense as incurred. Improvements to premises and equipment which extend the useful lives of the assets are capitalized. Gains and losses resulting from the disposal of premises and equipment are included in current operations. Rates of depreciation are based on the following depreciable lives: buildings, 30 years; furniture, five to seven years; equipment, three to five years; and leasehold improvement, the shorter of fifteen years or the lease term.

#### F. CONSOLIDATED STATEMENTS OF CASH FLOWS

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, and Federal funds sold. Generally, Federal funds are sold for one-day periods.

As more fully described in Note 9, 134,917 shares of Series C Preferred stock were automatically converted to 20,804 shares of the Bank's common stock on September 15, 1995 with a stated value of \$465,000. In November 1996, an amendment to the conversion resulted

F-17

### THE BANK OF HEMET AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

DECEMBER 31, 1998, 1997 AND 1996

#### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

in the issuance of an additional 6,533 in common shares and an increase in the stated value by \$147,000. These are noncash transactions and are not reflected in the consolidated statement of cash flows. As a result of this amendment, a supplemental cash dividend and a special cash distribution to all former holders of Preferred stock in the amount of \$26,000 was paid in November 1996.

#### G. OTHER REAL ESTATE OWNED

Other real estate owned represents real estate acquired by foreclosure or deed in lieu of foreclosure in satisfaction of commercial and residential real estate loans and is carried at the lower of the recorded investment in the property or its fair value, less estimated carrying costs and costs of disposition. At the time of foreclosure, the value of the underlying loan is written down to the fair value of the real estate to be acquired by a charge to the allowance for loan and lease losses, if necessary. Any subsequent write-downs are charged to noninterest expense. Operating expenses of such properties, net of related income and gains or losses on their disposition, are recorded in noninterest expense.

#### H. INCOME TAXES

The Bank applies an asset and liability approach in accounting for income taxes payable or refundable at the date of the financial statements as a result of all events that have been recognized in the financial statements and as measured by the provisions of enacted tax laws. Additionally, deferred tax assets are evaluated and a valuation allowance is established if it is "more likely than not" that all or a portion of the deferred tax asset will not be realized.

#### I. EARNINGS PER SHARE

The FASB issued SFAS No. 128, "Earnings per Share" (EPS) effective for both interim and annual reporting periods ending after December 15, 1997. SFAS No. 128 replaces primary EPS with basic EPS, and fully diluted EPS with diluted EPS. Basic EPS excludes dilution and is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted EPS is computed in a similar manner as fully diluted EPS, and reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the Bank. All periods presented in the accompanying consolidated financial statements have been restated to conform with SFAS No. 128. The following is a reconciliation of the numerators and

F-18

THE BANK OF HEMET AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

DECEMBER 31, 1998, 1997 AND 1996

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

denominators used in the calculation of basic EPS and diluted EPS for the years ended December 31, 1998, 1997 and 1996.

	EARNINGS	SHARES	EPS
	-----	-----	-----
<S>	<C>	<C>	<C>
FOR THE YEAR ENDED 1998			
Net Income.....	\$ 2,823,000		
BASIC EARNINGS PER SHARE			
Income available to Common Stockholders.....	2,823,000	844,252	\$ 3.34
			-----
EFFECT OF DILUTIVE SECURITIES			
Stock Options.....		30,373	
		-----	
DILUTED EARNINGS PER SHARE			
Income available to Common Stockholders and assumed conversions.....	\$ 2,823,000	874,625	\$ 3.23
	-----	-----	-----
	-----	-----	-----
FOR THE YEAR ENDED 1997			
Net Income.....	\$ 2,802,000		
BASIC EARNINGS PER SHARE			
Income available to Common Stockholders.....	2,802,000	863,262	\$ 3.25
			-----
EFFECT OF DILUTIVE SECURITIES			
Stock Options.....		26,458	
		-----	
DILUTED EARNINGS PER SHARE			
Income available to Common Stockholders and assumed conversions.....	\$ 2,802,000	889,720	\$ 3.15
	-----	-----	-----
	-----	-----	-----
FOR THE YEAR ENDED 1996			
Net Income.....	\$ 1,373,000		
Less: Preferred stock cash dividend.....	(26,000)		
	-----		
BASIC EARNINGS PER SHARE			
Income available to Common Stockholders.....	1,347,000	881,705	\$ 1.53
			-----
EFFECT OF DILUTIVE SECURITIES			
Stock Options.....		12,118	
Preferred Stock.....	26,000		
	-----	-----	
DILUTED EARNINGS PER SHARE			
Income available to Common Stockholders and assumed conversions.....	\$ 1,373,000	893,823	\$ 1.53
	-----	-----	-----
	-----	-----	-----

</TABLE>

In May 1997, the Bank concluded a Tender Offer which resulted in the repurchase of 50,626 shares of common stock at the offering price of \$27.00 per share. The decrease to common stock was \$1,367,000 plus offering costs of \$31,000.

F-19

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

DECEMBER 31, 1998, 1997 AND 1996

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)  
J. POSTRETIREMENT BENEFITS AND STOCK OPTIONS

The Bank has a salary continuation plan for certain key management personnel. The plan provides for payments for fifteen years commencing within 60 days upon reaching age 65, or death. The Bank measures the obligations to provide these future postretirement benefits over the estimated remaining years of benefit. Salary continuation expense was \$39,000, \$29,000, and \$31,000 for the years ended December 31, 1998, 1997 and 1996, respectively. The Bank is committed to pay \$1,875,000 over the pay out periods of the plan.

In 1995, the FASB issued SFAS No. 123, "Accounting for Stock-Based Compensation," which permits either adoption of the new standard's principles for recording the estimated value of stock-based compensation over the applicable vesting period, or permits continued application of existing accounting standards, with disclosure of any unrecorded cost under the new standard and the related effect on earnings per share. The Bank adopted SFAS No. 123 in 1996, and elected to adopt the disclosure provisions of the new standard only. As the Bank issued no stock-based compensation in 1996, adoption of this standard had no effect on the Bank's financial position or disclosures for the year ended December 31, 1996. During 1997, the Bank granted stock options as more fully described in Note 7. No stock-based compensation was issued in 1998.

The Bank established a 401(k) plan effective August 1, 1997. Employees who have completed one year of service and meet certain other requirements are eligible for enrollment. Employees may contribute a percentage of their salary pursuant to IRS regulatory maximums, and under the plan, the Bank matches 40% of the first 5% of salary contributed using forfeitures and cash. Participants vest immediately in their own contributions with 100% vesting in Bank's contributions occurring after five years of credited service. The Bank's expense for contributions to this plan was \$42,000 and \$7,000 during 1998 and 1997, respectively.

## K. NEW ACCOUNTING PRONOUNCEMENTS AND RECLASSIFICATIONS

In June 1997, the FASB issued SFAS Nos. 130 and 131, "Reporting Comprehensive Income" and "Disclosures about Segments of an Enterprise and Related Information." The Bank adopted SFAS Nos. 130 and 131 in 1998. As none of the Bank's accounts would create differences between reported net income and comprehensive income as defined by SFAS No. 130, adoption of this new standard has no impact on the Bank's results of operations or disclosures. Management does not believe that the adoption of SFAS No. 131 has a material impact on the Bank's current disclosure of its one operating segment of banking as described in Note 1.A.

In June 1998, the FASB issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." This statement establishes accounting and reporting standards for derivative instruments and for hedging activities. The new standard is effective for 2000 and is not expected to have a material impact on the Bank's financial statements.

F-20

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

DECEMBER 31, 1998, 1997 AND 1996

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Certain reclassifications of prior years financial data have been made to conform to the current reporting practices of the Bank.

## 2. INVESTMENT SECURITIES HELD TO MATURITY

The amortized cost and fair value of investment securities held to maturity are as follows at December 31, 1998 and 1997:

	AMORTIZED COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	FAIR VALUE
<S>	<C>	<C>	<C>	<C>
DECEMBER 31, 1998				
U.S. government agencies.....	\$ 24,882,000	\$ 6,000	\$ (4,000)	\$ 24,884,000

DECEMBER 31, 1997

U.S. government agencies.....	\$ 24,833,000	\$ 10,000	\$ (1,000)	\$ 24,842,000
-------------------------------	---------------	-----------	------------	---------------

</TABLE>

Investment securities with a book value of \$10,000,000 and \$7,000,000 at December 31, 1998 and 1997, respectively, were pledged to secure public deposits and for other purposes as required or permitted by law. The estimated fair values of pledged securities were \$10,003,000 and \$7,001,000 at December 31, 1998 and 1997, respectively.

The amortized cost and fair values of investment securities held to maturity at December 31, 1998, by contractual maturity, are as follows:

<TABLE>

<CAPTION>

	AMORTIZED COST	ESTIMATED FAIR VALUE
<S>	<C>	<C>
Due in one year or less.....	\$ 18,000,000	\$ 18,005,000
Due after one year through five years.....	6,000,000	5,997,000
Due after five years through ten years.....	--	--
Due after 10 years.....	882,000	882,000
Total.....	\$ 24,882,000	\$ 24,884,000

</TABLE>

U.S. government agency securities of \$882,000 at December 31, 1998 represent preferred stock of the Federal Home Loan Bank (FHLB), which has no maturity date.

3. LOANS AND LEASES, NET

The Bank's loans, commitments, and standby letters of credit have been granted to customers primarily in the Inland Empire area of Southern California. Prevailing economic conditions, including real estate values and other factors may affect certain borrowers' ability to repay loans. Although management believes the level of allowance for loan and lease losses is adequate to absorb losses inherent in the loan portfolio, declines in the local economy and/or

F-21

THE BANK OF HEMET AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

DECEMBER 31, 1998, 1997 AND 1996

3. LOANS AND LEASES, NET (CONTINUED)

increases in the interest rate charged on adjustable rate loans may result in increasing loan and other real estate owned losses that cannot be reasonably estimated at December 31, 1998. The most significant category of collateral is real estate, principally commercial and industrial income-producing properties. At December 31, 1998, the Bank's loan portfolio included approximately \$27,635,000 of fixed rate loans. The loan and lease portfolio consisted of the following at December 31, 1998 and 1997:

<TABLE>

<CAPTION>

	1998	1997
<S>	<C>	<C>
Commercial.....	\$ 10,016,000	\$ 10,033,000
Real Estate.....	197,189,000	181,524,000
Installment.....	1,002,000	1,065,000
Lease finance receivables.....	--	--
All other loans (including overdrafts).....	391,000	411,000
Deferred loan origination fees, net.....	208,598,000 (796,000)	193,033,000 (746,000)
Allowance for loan and lease losses.....	207,802,000 (2,232,000)	192,287,000 (2,116,000)
Total Loans and Leases, net.....	\$ 205,570,000	\$ 190,171,000

</TABLE>

Nonaccruing loans totaled approximately \$1,578,000 and \$2,902,000 at December 31, 1998 and 1997, respectively. Interest income that would have been recognized on nonaccrual loans if they had performed in accordance with the terms of the loans was approximately \$277,000, \$391,000 and \$302,000 for the years ended December 31, 1998, 1997 and 1996, respectively. At December 31, 1998 and 1997, respectively, the Bank had an insignificant amount of loans past due 90 days or more in interest or principal and still accruing interest.

At December 31, 1998 and 1997, loans that were considered impaired totaled \$3,312,000 and \$4,708,000, respectively, all of which had a related allowance for loan and lease loss aggregating \$287,000 and \$402,000, respectively. Impaired loans amounting to \$1,578,000 and \$2,902,000 were on a non-accruing basis at December 31, 1998 and 1997, respectively. Substantially all of the impaired loans were collateral dependent and were measured using the fair value of the collateral. For the years ended December 31, 1998, 1997 and 1996, the Bank recognized interest income on these impaired loans of \$115,000, \$390,000 and \$159,000, respectively. The average outstanding principal balance of impaired loans was \$4,010,000, \$4,770,000 and \$4,585,000 during 1998, 1997 and 1996, respectively.

From time to time, the Bank has originated first and second mortgages for resale on the secondary market to Federal Home Loan Mortgage Corporation (FHLMC), and Federal National Mortgage Association (FNMA). Any gains or losses on the sales of these loans are recognized at the time of sale. The Bank retains servicing rights to these loans. Servicing arrangements provide for the Bank to maintain all records related to the servicing agreement,

F-22

THE BANK OF HEMET AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

DECEMBER 31, 1998, 1997 AND 1996

3. LOANS AND LEASES, NET (CONTINUED)

to assume responsibility for billing mortgagors, to collect periodic mortgage payments, and to perform various other activities necessary to the mortgage servicing function. The Bank receives as compensation a servicing fee based on the principal balance of the outstanding loans. Servicing fee income amounted to approximately \$57,000 during 1998, \$92,000 during 1997, and \$108,000 during 1996. The total unpaid principal balance of the mortgage servicing portfolio amounted to approximately \$18,333,000 and \$23,617,000 at December 31, 1998 and 1997, respectively.

The Bank has pledged certain qualifying residential loans amounting to \$0 and \$5,794,000 at December 31, 1998 and 1997, respectively, to secure public deposits, as required by state law.

The activity in the allowance for loan and lease losses is summarized as follows:

<TABLE>  
<CAPTION>

	1998	1997	1996
<S>	<C>	<C>	<C>
Balance at Beginning of Year.....	\$ 2,116,000	\$ 2,241,000	\$ 2,135,000
Recoveries on loans previously charged off.....	298,000	76,000	20,000
Loans charged off.....	(182,000)	(451,000)	(902,000)
Provision charged to operating expense.....	--	250,000	988,000
Balance at End of Year.....	\$ 2,232,000	\$ 2,116,000	\$ 2,241,000

</TABLE>

As part of its normal banking activities, the Bank has extended credit to certain directors and officers and the companies with which they are associated (related parties). All related party loans were current as to principal and interest as of December 31, 1998 and 1997. In management's opinion, these loans were made in the ordinary course of business at prevailing rates and terms. Total commitments for such loans amounted to \$2,585,000 and \$3,330,000 at December 31, 1998 and 1997, of which \$237,000 and \$425,000 were undisbursed, respectively. There were no new commitments on such loans, and expired loan commitments amounted to \$160,000. Advances on existing commitments were \$28,000 in 1998, with repayments of \$585,000.

F-23

THE BANK OF HEMET AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

4. PREMISES AND EQUIPMENT

Major classifications of premises and equipment are summarized as follows:

<TABLE>  
<CAPTION>

	DECEMBER 31,	
	1998	1997
<S>	<C>	<C>
Land.....	\$ 211,000	\$ 211,000
Buildings.....	985,000	983,000
Furniture and equipment.....	1,499,000	1,319,000
Leasehold improvements.....	355,000	343,000
	-----	-----
	3,050,000	2,856,000
Less: Accumulated depreciation and amortization.....	(1,509,000)	(1,219,000)
	-----	-----
Total.....	\$ 1,541,000	\$ 1,637,000
	-----	-----

</TABLE>

The amount of depreciation and amortization included in operating expense was \$299,000, \$259,000, and \$287,000 for the years ended December 31, 1998, 1997, and 1996, respectively.

The Bank occupies its office premises under separate long-term, noncancellable leases which expire in various years through 2004. All leases are accounted for as operating leases. At December 31, 1998, future minimum lease commitments and future minimum sublease rental income under all noncancellable leases are as follows:

<TABLE>  
<CAPTION>

	LEASE COMMITMENTS
<S>	<C>
1999.....	\$ 355,000
2000.....	354,000
2001.....	312,000
2002.....	203,000
2003.....	95,000
Succeeding Years.....	5,000
	-----
Total.....	\$ 1,324,000
	-----

</TABLE>

THE BANK OF HEMET AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

DECEMBER 31, 1998, 1997 AND 1996

5. INCOME TAXES

The current and deferred amounts of the provisions for (benefit from) income taxes for the years ended December 31, 1998, 1997, and 1996 consisted of the following:

<TABLE>  
<CAPTION>

	YEARS ENDED DECEMBER 31,		
	1998	1997	1996
<S>	<C>	<C>	<C>
Current:			
Federal.....	\$ 1,320,000	\$ 1,106,000	\$ 1,059,000
State.....	516,000	378,000	357,000
	-----	-----	-----
Total.....	1,836,000	1,484,000	1,416,000
	-----	-----	-----
Deferred:			
Federal.....	197,000	353,000	(311,000)



State.....	2,000	160,000	(96,000)
Total.....	199,000	513,000	(407,000)
	\$ 2,035,000	\$ 1,997,000	\$ 1,009,000

</TABLE>

Deferred taxes arise from temporary differences between income reported for financial reporting purposes and that reported for federal and state income tax purposes. The tax effects of the principal temporary differences resulting in deferred taxes were:

<TABLE>  
<CAPTION>

	YEARS ENDED DECEMBER 31,		
	1998	1997	1996
<S>	<C>	<C>	<C>
Expenses reported on a different basis for tax purposes.....	\$ 231,000	\$ 443,000	\$ (342,000)
Depreciation computed differently on tax returns than for financial statements.....	(16,000)	(3,000)	(18,000)
Deferred compensation.....	(16,000)	(12,000)	(13,000)
Provision for loan and lease losses deducted in tax return over (under) amount charged for financial statement purposes.....	0	85,000	(34,000)
	\$ 199,000	\$ 513,000	\$ (407,000)

</TABLE>

F-25

THE BANK OF HEMET AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

DECEMBER 31, 1998, 1997 AND 1996

5. INCOME TAXES (CONTINUED)

Total tax expense differed from the amount computed using the federal statutory rate as follows:

<TABLE>  
<CAPTION>

	1998		1997		1996	
	AMOUNT	PERCENT OF PRETAX INCOME	AMOUNT	PERCENT OF PRETAX INCOME	AMOUNT	PERCENT OF PRETAX INCOME
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Tax expense at federal statutory rate.....	\$ 1,652,000	34.0%	\$ 1,632,000	34.0%	\$ 810,000	34.0%
State income tax, net of federal tax benefit.....	342,000	7.0	355,000	7.4	172,000	7.2
Tax exempt interest.....	0	0.0	(1,000)	(0.0)	(4,000)	(0.2)
Other.....	41,000	0.9	11,000	0.2	31,000	1.4
Total.....	\$ 2,035,000	41.9%	\$ 1,997,000	41.6%	\$ 1,009,000	42.4%

</TABLE>

At December 31, 1998 and 1997, the components of the net deferred tax asset which is included in other assets on the accompanying consolidated balance sheets were as follows:

<TABLE>  
<CAPTION>

	1998	1997
<S>	<C>	<C>
Allowance for loan and lease losses.....	\$ 590,000	\$ 590,000
Deferred compensation.....	245,000	229,000
Other real estate owned.....	0	13,000
State income tax.....	175,000	128,000
Depreciation.....	53,000	37,000
Other.....	(157,000)	108,000

Total.....	\$ 906,000	\$ 1,105,000
	-----	-----
	-----	-----

</TABLE>

6. COMMITMENTS AND CONTINGENCIES

In order to meet the financing needs of its customers in the normal course of business, the Bank is a party to financial instruments with off-balance sheet risk. These financial instruments include commitments to extend credit and 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 amounts do not necessarily represent future cash requirements. Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. The Bank does not enter into any interest rate swaps or caps, or forward or future contracts.

The nature of the off-balance sheet risk inherent in these instruments is the possibility of accounting losses resulting from (1) the failure of another party to perform according to the

F-26

THE BANK OF HEMET AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

DECEMBER 31, 1998, 1997 AND 1996

6. COMMITMENTS AND CONTINGENCIES (CONTINUED)

terms of a contract that would cause a draw on a standby letter of credit, or (2) changes in market rates of interest for those few commitments and undisbursed loans which have fixed rates of interest. To minimize this risk, the Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. The decision as to whether collateral should be required is based on the circumstances of each specific commitment or conditional obligation.

To varying degrees, these instruments involve elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets. The Bank's exposure to credit loss in the event of non-performance by the other party to the financial instruments for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. At December 31, 1998, the Bank had commitments to extend credit of approximately \$9,752,000 and obligations under standby letters of credit of approximately \$1,116,000. Management does not believe there will be any material losses as a result of these letters of credit and loan commitments.

At December 31, 1998, the Bank has available a borrowing line of credit with the FHLB in the amount of \$14,163,000 using previously approved residential and commercial real estate mortgage loans totaling \$21,253,000 to secure the line of credit. There was no utilization of this line of credit during 1998.

The Bank has available reverse repurchase lines of credit with two broker/dealers aggregating \$30,000,000 at December 31, 1998. These lines are subject to normal terms for such arrangements. There was no utilization of these lines during 1998. At December 31, 1998, investment securities with a market value of approximately \$14,000,000 were available for these reverse repurchase lines of credit.

The Bank is required to maintain reserve balances with the Federal Reserve Bank. The amounts of these reserve balances at December 31, 1998 and 1997 were \$692,000 and \$721,000, respectively.

In April 1997, litigation relating to the acquisition of Inland Savings and Loan (Inland) was filed against the Bank and certain of its directors alleging improper adjustments to the value of the Bank's Preferred stock (see Note 9). The named plaintiffs have sued on behalf of a class consisting of former owners of the Bank's Preferred stock. The action alleges breach of contract and breach of fiduciary duty and seeks compensatory damages in excess of \$2 million together with punitive damages. The Bank contends that these allegations are without merit, and intends to vigorously defend against these claims. Any potential losses to the Bank as a result of this action are not reasonably estimable, and accordingly no reserve for loss has been established in the accompanying consolidated financial statements. Any losses which might be suffered by the Bank related to this proceeding could impact the Bank's future profitability.

F-27

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

DECEMBER 31, 1998, 1997 AND 1996

## 6. COMMITMENTS AND CONTINGENCIES (CONTINUED)

In addition, the Bank is a defendant in various legal proceedings resulting from normal banking business. In the opinion of management and the Bank's legal counsel, the disposition of such litigation will not have a material effect on the Bank's consolidated financial condition or results of operations.

## 7. STOCK OPTION PLAN

In January 1987, the former Hemet Bancorp established a stock option plan (the 1987 Plan) which was assumed by the Bank that provides for the granting of incentive and nonqualified stock options to certain full-time salaried officers and management level employees. Additionally, in June 1994, the Bank established a second stock option plan (the 1994 Plan) which authorized the issuance of 75,000 shares, of which 31,000 shares were granted in 1994 and 21,000 shares were granted in 1997 to various officers of the Bank. As of December 31, 1998, there were no shares of common stock granted under the 1987 Plan. At December 31, 1998, 27,000 shares of common stock were reserved for grant under the 1994 Plan which includes 4,000 shares forfeited during 1996. The stock options are exercisable at a price equal to market value on the date of grant. Options expire not more than ten years after the date of grant. Options are exercisable at 20% of the options outstanding per year. Transactions for the three years ended December 31, 1998, are as follows:

&lt;TABLE&gt;

&lt;CAPTION&gt;

	OPTIONS OUTSTANDING	WEIGHTED AVERAGE EXERCISE PRICE PER SHARE
	-----	-----
<S>	<C>	<C>
Balance, December 31, 1995.....	89,938	\$ 9.00
Options exercised (1987 Plan).....	(58,938)	\$ 7.51
Options exercised (1994 Plan).....	(1,032)	\$ 12.00
Options forfeited (1994 Plan).....	(4,000)	\$ 12.00
Options granted.....	--	--
	-----	-----
Balance, December 31, 1996.....	25,968	\$ 12.00
Options exercised.....	--	--
Options granted (1994 Plan).....	21,000	\$ 22.50
	-----	-----
Balance, December 31, 1997.....	46,968	\$ 16.69
Options exercised.....	--	--
Options granted (1994 Plan).....	--	--
	-----	-----
Balance, December 31, 1998.....	46,968	\$ 16.69
	-----	-----
Exercisable at December 31, 1998.....	24,968	\$ 13.77
	-----	-----

&lt;/TABLE&gt;

The Bank accounts for options according to Accounting Principles Board Opinion No. 25, under which no compensation cost is recognized. The Bank's pro forma net income and diluted earnings per share assuming the Bank recorded compensation cost in 1998 and 1997 for the options granted in 1997 in accordance with SFAS No. 123 would not have a material

F-28

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

DECEMBER 31, 1998, 1997 AND 1996

## 7. STOCK OPTION PLAN (CONTINUED)

effect on the Bank's consolidated results of operations. Pro forma disclosures are not presented for 1996 because there were no options granted during that year. Because the method of accounting required under SFAS No. 123 is not applicable for options granted prior to January 1, 1996, the pro forma impact of compensation costs on net income and diluted earnings per share as presented above may not be representative of the impact which could be realized in future years. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions used for grants in 1997: risk-free interest rate of 6.25%, dividend yield of 6%, expected life of 5 years, and expected volatility of 25%.

8. OTHER EXPENSES

The following is a breakdown of other expenses for the years ended December 31, 1998, 1997 and 1996:

<TABLE>  
<CAPTION>

	1998	1997	1996
<S>	<C>	<C>	<C>
Data processing and other outside services.....	\$ 326,000	\$ 363,000	\$ 357,000
Deposit insurance assessments.....	84,000	87,000	191,000
Special SAIF assessment.....	--	--	402,000
Professional fees.....	418,000	383,000	318,000
Office supplies, postage and telephone.....	488,000	435,000	433,000
Other.....	720,000	670,000	596,000
Total.....	\$ 2,036,000	\$ 1,938,000	\$ 2,297,000

</TABLE>

9. BUSINESS COMBINATIONS

On October 16, 1992, the Bank acquired Inland Savings and Loan Association and subsidiaries in a business combination accounted for as a purchase under Accounting Principles Board Opinion No. 16. Inland Savings and Loan was primarily engaged in banking services. The shareholders of Inland Savings and Loan received .31474 shares of the Bank's Series 'C' Preferred stock (the Preferred stock) and .31474 shares of the Bank's common stock, for each share of Inland Savings and Loan stock. The Preferred stock had cumulative dividends of 5% per annum of the stock's stated value, payable semi-annually on the 15th of March and September each year. The stated value of the Preferred stock represented the original book value of the stock, less certain charges against that value, as defined and provided for in the purchase agreement and as detailed below. Charges against the stated value of the Preferred stock subsequent to 1992 represented period costs that were charged to operations as incurred and that were subsequently charged against the stated value of Preferred stock through an equity transfer from Preferred stock to retained earnings.

F-29

THE BANK OF HEMET AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

DECEMBER 31, 1998, 1997 AND 1996

9. BUSINESS COMBINATIONS (CONTINUED)

Voting rights for the Preferred stock equaled 1/10 of a share of the Bank's common stock. The Preferred stock was automatically converted to the Bank's common stock on September 15, 1995 using a ratio of the Preferred stock's stated value to the Bank's adjusted net book value, as defined in the purchase agreement. The number of shares of common stock delivered upon the automatic conversion of Preferred stock was equal to .1542 shares of common stock for each share of Preferred stock for a total of 20,804 shares of common stock. In November 1996, an amendment to the conversion resulted in the issuance of an additional 6,533 in common shares, an increase in the stated value by \$147,000 (principally related to the reversal of tax assessments), and a revised exchange ratio of .2027 shares of common stock for each share of Preferred stock. See Note 6 for a discussion of litigation regarding adjustments to the value of the Preferred stock.

As a result of the mark-to-market analysis of the Inland Savings and Loan purchase, various asset and liability accounts were adjusted to appropriate market values. The significant valuations were in the areas of loans, other real estate owned, Bank premises, time deposits, other borrowings, and a core deposit intangible. Amortization of each of the mark-to-market valuation accounts is taken over their expected useful lives, as estimated in the original mark to market analysis. The Bank periodically reviews the estimated useful lives of the mark-to-market assets and liabilities and makes adjustments as necessary.

10. FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value estimates of financial instruments for both assets and liabilities are made at a discrete point in time based on relevant market information and information about the financial instruments. Because no active market exists for a significant portion of the Bank's financial instruments, fair value estimates are based on judgments regarding current economic conditions, risk characteristics of various financial instruments, prepayment assumptions, future expected loss experience and other such factors. These estimates are subjective in nature and involve uncertainties and matters of

significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

The Bank intends to hold the majority of its assets and liabilities to their stated maturities. Thus, management does not believe that the bulk sale concepts applied to certain problem loans for purposes of measuring the impact of credit risk on fair values of said assets is reasonable to the operations of the Bank and does not fairly present the values realizable over the long term on assets that will be retained by the Bank. Therefore, the Bank does not intend to realize any significant differences between carrying value and fair value through sale or other disposition. No attempt should be made to adjust stockholders' equity to reflect the following fair value disclosures as management believes them to be inconsistent with the philosophies and operations of the Bank.

F-30

THE BANK OF HEMET AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

DECEMBER 31, 1998, 1997 AND 1996

10. FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

In addition, the fair value estimates are based on existing on-and off-balance sheet financial instruments without attempting to estimate the value of existing and anticipated future customer relationships and the value of assets and liabilities that are not considered financial instruments. Significant assets and liabilities that are not considered financial assets or liabilities include the branch network, deferred tax assets, other real estate owned, and premises and equipment.

The following methods and assumptions were used to estimate the fair value of financial instruments.

INVESTMENT SECURITIES

For U.S. government agency securities, fair values are based on market prices. For other investment securities, fair value equals quoted market price, if available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities.

LOANS

The fair value for loans with variable interest rates is the carrying amount. The fair value of fixed rate loans is derived by calculating the discounted value of future cash flows expected to be received by the various homogeneous categories of loans. All loans have been adjusted to reflect changes in credit risk.

DEPOSITS

The fair value of demand deposits, savings deposits, and money market deposits are defined as the amounts payable on demand at year end. The fair value of fixed maturity certificates of deposit is estimated based on the discounted value of the future cash flows expected to be paid on the deposits.

COMMITMENTS TO EXTEND CREDIT AND STANDBY LETTERS OF CREDIT

The fair value of commitments is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the parties involved. For fixed rate loan commitments, fair value also considers the difference between current levels of interest rates and committed rates. The fair value of these unrecorded financial instruments is not material to the Bank's financial position or fair value disclosures at December 31, 1998 and 1997 (see Note 6).

F-31

THE BANK OF HEMET AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

DECEMBER 31, 1998, 1997 AND 1996

10. FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

The estimated fair values of the Bank's financial instruments are as follows:

<TABLE>  
<CAPTION>

CARRYING VALUE	FAIR VALUE
-----	-----

<u>&lt;S&gt;</u>	<u>&lt;C&gt;</u>	<u>&lt;C&gt;</u>
DECEMBER 31, 1998		
Financial Assets		
Cash and cash equivalents.....	\$ 16,996,000	\$ 16,996,000
Investment securities.....	24,882,000	24,884,000
Loans and leases, net.....	205,570,000	207,369,000
Financial Liabilities		
Deposits.....	230,385,000	231,000,000
DECEMBER 31, 1997		
Financial Assets		
Cash and cash equivalents.....	\$ 19,521,000	\$ 19,521,000
Investment securities.....	24,833,000	24,842,000
Loans and leases, net.....	190,171,000	190,176,000
Financial Liabilities		
Deposits.....	219,211,000	219,283,000
<u>&lt;/TABLE&gt;</u>		

11. REGULATORY MATTERS

Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank is required to maintain certain minimum capital levels in relation to Bank assets. Under regulations, banks are categorized as critically undercapitalized, significantly undercapitalized, undercapitalized, adequately capitalized and well capitalized. Failure to meet minimum capital requirements can initiate certain mandatory--and possibly additional discretionary--actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements. According to regulatory guidelines, the Bank is considered well capitalized as measured using a leverage ratio, as well as based on risk-weighting assets.

F-32

THE BANK OF HEMET AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

DECEMBER 31, 1998, 1997 AND 1996

11. REGULATORY MATTERS (CONTINUED)

A comparison of the Bank's actual regulatory capital with minimum requirements for adequately capitalized and well capitalized banks, as defined by regulation, is shown below.

<u>&lt;TABLE&gt;</u>	<u>&lt;CAPTION&gt;</u>					
	ACTUAL		TO BE ADEQUATELY CAPITALIZED		TO BE WELL CAPITALIZED	
	AMOUNT	RATIO	AMOUNT	RATIO	AMOUNT	RATIO
<u>&lt;S&gt;</u>	<u>&lt;C&gt;</u>	<u>&lt;C&gt;</u>	<u>&lt;C&gt;</u>	<u>&lt;C&gt;</u>	<u>&lt;C&gt;</u>	<u>&lt;C&gt;</u>
AS OF DECEMBER 31, 1998						
Tier 1 Risk-Based Capital (To Risk Weighted Assets).....	\$ 21,024,000	9.99%	\$ 8,413,000	4.0%	\$ 12,621,000	6.0%
Total Risk-Based Capital (To Risk Weighted Assets).....	\$ 23,257,000	11.06%	\$ 16,827,000	8.0%	\$ 21,036,000	10.0%
Tier 1 Capital (To Average Assets).....	\$ 21,024,000	8.31%	\$ 10,115,000	4.0%	\$ 12,645,000	5.0%
AS OF DECEMBER 31, 1997						
Tier 1 Risk-Based Capital (To Risk Weighted Assets).....	\$ 20,228,000	10.43%	\$ 7,753,000	4.0%	\$ 11,630,000	6.0%
Total Risk-Based Capital (To Risk Weighted Assets).....	\$ 22,344,000	11.53%	\$ 15,507,000	8.0%	\$ 19,384,000	10.0%
Tier 1 Capital (To Average Assets).....	\$ 20,228,000	8.53%	\$ 9,486,000	4.0%	\$ 11,858,000	5.0%
<u>&lt;/TABLE&gt;</u>						

12. SUBSEQUENT EVENTS (UNAUDITED)

A. The accompanying unaudited consolidated financial statements include the accounts of The Bank of Hemet and its wholly-owned subsidiary, BankLink Corporation, and gives effect to all adjustments (which are normal recurring accruals) necessary in the opinion of management to present fairly the financial statements for the interim periods presented. All significant intercompany balances and transactions have been eliminated. The unaudited financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission and do not include all the information and footnotes required by generally accepted accounting

principles for complete financial statements and may be subject to year-end adjustments, which, in the opinion of management, are necessary for a fair statement of the results of the interim periods.

- B. On January 5, 1999, the Bank announced the signing of a revised definitive agreement with Pacific Community Banking Group ("PCBG") for the acquisition by PCBG of the Bank. The agreement provides for total consideration of \$51.00 per share, as well as one PCBG warrant per share, upon consummation of the acquisition. The warrant will allow the holder to purchase one share of PCBG common stock during a ten-year period at an exercise price 22% above the initial public offering price of PCBG common stock. The price to be paid to each of the Bank's shareholders may be increased in accordance with

F-33

THE BANK OF HEMET AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

DECEMBER 31, 1998, 1997 AND 1996

12. SUBSEQUENT EVENTS (UNAUDITED) (CONTINUED)

a formula related to the aggregate net proceeds to be received by PCBG in the underwritten initial public offering. The consummation of the acquisition is subject to certain conditions including continuation of the Bank's operating results, regulatory and shareholder approval and certain other conditions. The acquisition is also subject to the successful completion of an underwritten initial public offering by PCBG whereby the proceeds of such offering will be used to make the cash payment to selling shareholders of the Bank and to purchase the outstanding shares of Valley Bank in Moreno Valley, California. The values allocated to the assets and liabilities of the Bank could be different than those included in these consolidated financial statements.

- C. Basic earnings per share excludes dilution and is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the Bank. The actual number of shares outstanding at March 31, 1999 was 844,252. The number of shares used in the calculation of basic earnings per share was 844,252 for the three months ended March 31, 1999, and 844,252 for the three months ended March 31, 1998. The number of shares used in the calculation of diluted earnings per share was 871,364 for the three months ended March 31, 1999, and 871,548 for the three months ended March 31, 1998.

F-34

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors  
Valley Bank  
Moreno Valley, California

We have audited the accompanying balance sheets of Valley Bank as of December 31, 1998 and 1997, and the related statements of operations, stockholders' equity and cash flows for each of the three years in the period ended December 31, 1998. 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 audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Valley Bank as of December 31, 1998 and 1997, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 1998, in conformity with generally accepted accounting principles.

McGLADREY & PULLEN, LLP

San Bernardino, California  
January 15, 1999

F-35

## VALLEY BANK

## BALANCE SHEETS

MARCH 31, 1999, DECEMBER 31, 1998 AND 1997

<TABLE> <CAPTION>	MARCH 31, 1999	1998	1997
<S>	(UNAUDITED)	<C>	<C>
ASSETS			
Cash and due from banks.....	\$ 6,111,000	\$ 6,485,000	\$ 5,487,000
Federal funds sold.....	8,899,000	13,780,000	4,800,000
Held-to-maturity securities, fair value of 1999 \$24,084,000; 1998 \$15,642,000; 1997 \$13,920,000 (Note 2).....	24,077,000	15,585,000	13,856,000
Loans, net of allowance for loan losses of 1999 \$1,115,000; 1998 \$1,118,000; 1997 \$1,058,000 (Notes 3, 4 and 10).....	41,334,000	41,437,000	44,202,000
Loans held for sale (Note 3).....	400,000	594,000	--
Bank premises and equipment, net (Note 5).....	2,126,000	2,158,000	2,160,000
Other real estate owned.....	1,611,000	1,749,000	1,711,000
Accrued interest receivable.....	555,000	611,000	561,000
Cash surrender value of life insurance (Note 9).....	712,000	712,000	661,000
Deferred tax assets (Note 7).....	730,000	730,000	642,000
Other assets.....	944,000	868,000	486,000
<b>TOTAL ASSETS.....</b>	<b>\$ 87,499,000</b>	<b>\$ 84,709,000</b>	<b>\$ 74,566,000</b>
LIABILITIES AND STOCKHOLDERS' EQUITY			
Liabilities			
Deposits (Notes 2 and 6):			
Noninterest-bearing demand.....	\$ 20,319,000	\$ 20,061,000	\$ 17,517,000
Interest bearing:			
Demand.....	29,143,000	27,618,000	23,964,000
Savings.....	11,752,000	11,610,000	11,268,000
Other time.....	17,216,000	16,450,000	13,490,000
<b>TOTAL DEPOSITS.....</b>	<b>78,430,000</b>	<b>75,739,000</b>	<b>66,239,000</b>
Accrued interest payable and other liabilities (Note 9).....	182,000	238,000	456,000
ESOP bank notes payable (Note 9).....	448,000	478,000	579,000
<b>TOTAL LIABILITIES.....</b>	<b>79,060,000</b>	<b>76,455,000</b>	<b>67,274,000</b>
Commitments and Contingencies (Notes 8, 9 and 15)			
Stockholders' Equity (Notes 9, 11 and 12)			
Common stock, \$5 par value; 2,400,000 shares authorized; issued and outstanding 1,171,906 shares.....	5,860,000	5,860,000	5,860,000
Surplus.....	169,000	142,000	77,000
Retained earnings.....	2,815,000	2,684,000	1,895,000
	8,844,000	8,686,000	7,832,000
Less unearned ESOP shares 1999 82,308; 1998 87,794; 1997 109,410.....	405,000	432,000	540,000
<b>TOTAL STOCKHOLDERS' EQUITY.....</b>	<b>8,439,000</b>	<b>8,254,000</b>	<b>7,292,000</b>
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY.....</b>	<b>\$ 87,499,000</b>	<b>\$ 84,709,000</b>	<b>\$ 74,566,000</b>

&lt;/TABLE&gt;

See Notes to Financial Statements.

F-36

## VALLEY BANK

## STATEMENTS OF OPERATIONS

YEARS ENDED DECEMBER 31, 1998, 1997 AND 1996  
AND THE THREE MONTHS ENDED MARCH 31, 1999 AND 1998<TABLE>  
<CAPTION>THREE MONTHS ENDED MARCH  
31,



(UNAUDITED)					
	1999	1998	1998	1997	1996
<S>	<C>	<C>	<C>	<C>	<C>
Interest income on:					
Loans.....	\$ 1,035,000	\$ 1,259,000	\$ 4,959,000	\$ 4,784,000	\$ 4,266,000
Securities, taxable.....	267,000	190,000	724,000	764,000	703,000
Securities, nontaxable.....	8,000	15,000	54,000	76,000	100,000
Federal funds sold.....	112,000	95,000	444,000	354,000	269,000
<b>TOTAL INTEREST INCOME.....</b>	<b>1,422,000</b>	<b>1,559,000</b>	<b>6,181,000</b>	<b>5,978,000</b>	<b>5,338,000</b>
Interest expense on:					
Deposits.....	355,000	328,000	1,387,000	1,227,000	1,109,000
Other borrowings.....	11,000	14,000	51,000	55,000	10,000
	366,000	342,000	1,438,000	1,282,000	1,119,000
Net interest income before provision for loan losses.....	1,056,000	1,217,000	4,743,000	4,696,000	4,219,000
Provision for loan losses (Note 4).....	90,000	150,000	200,000	980,000	360,000
<b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES.....</b>	<b>966,000</b>	<b>1,067,000</b>	<b>4,543,000</b>	<b>3,716,000</b>	<b>3,859,000</b>
Other income:					
Service charges and other fees.....	438,000	433,000	1,714,000	1,858,000	1,657,000
Gain on sale of loans.....	220,000	--	1,057,000	772,000	375,000
Other.....	54,000	26,000	144,000	89,000	103,000
	712,000	459,000	2,915,000	2,719,000	2,135,000
Other expenses:					
Salaries, wages and employee benefits (Note 9).....	831,000	743,000	3,272,000	3,019,000	2,639,000
Furniture and equipment.....	112,000	109,000	441,000	426,000	452,000
Occupancy and expenses (Note 8).....	106,000	111,000	480,000	476,000	451,000
Other real estate.....	26,000	49,000	41,000	294,000	401,000
Legal and professional services.....	166,000	208,000	892,000	558,000	560,000
Telephone and postage.....	57,000	51,000	214,000	199,000	183,000
Office supplies.....	32,000	40,000	114,000	139,000	164,000
Other.....	122,000	242,000	631,000	526,000	361,000
	1,452,000	1,553,000	6,085,000	5,637,000	5,211,000
Income (loss) before income taxes.....	226,000	(27,000)	1,373,000	798,000	783,000
Income tax expense (Note 7).....	95,000	(18,000)	584,000	242,000	329,000
<b>NET INCOME (loss).....</b>	<b>\$ 131,000</b>	<b>\$ (9,000)</b>	<b>\$ 789,000</b>	<b>\$ 556,000</b>	<b>\$ 454,000</b>
Basic earnings (loss) per share.....	\$ 0.12	\$ (0.01)	\$ 0.73	\$ 0.53	\$ 0.41
Diluted earnings (loss) per share.....	\$ 0.11	\$ (0.01)	\$ 0.65	\$ 0.51	\$ 0.41

</TABLE>

See Notes to Financial Statements

F-37

VALLEY BANK

STATEMENTS OF STOCKHOLDERS' EQUITY

YEARS ENDED DECEMBER 31, 1998, 1997 AND 1996  
AND THREE MONTHS ENDED MARCH 31, 1999

<TABLE>

<CAPTION>

	COMMON STOCK			RETAINED EARNINGS	UNEARNED ESOP SHARES (NOTE 9)	TOTAL
	SHARES	PAR VALUE	SURPLUS			
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Balance, December 31, 1995.....	1,108,701	\$ 5,544,000	\$ --	\$ 1,218,000	\$ --	\$ 6,762,000
Net income.....	--	--	--	454,000	--	454,000
Issuance of ESOP notes payable.....	--	--	--	--	(327,000)	(327,000)
ESOP shares committed to be released.....	--	--	3,000	--	10,000	13,000

Balance, December 31, 1996.....	1,108,701	5,544,000	3,000	1,672,000	(317,000)	6,902,000
Net income.....	--	--	--	556,000	--	556,000
Stock dividend declared.....	55,333	277,000	55,000	(332,000)	--	--
Cash paid in lieu of fractional shares.....	--	--	--	(1,000)	--	(1,000)
Issuance of ESOP notes payable.....	--	--	--	--	(278,000)	(278,000)
ESOP shares committed to be released.....	--	--	16,000	--	55,000	71,000
Stock options exercised.....	7,872	39,000	3,000	--	--	42,000
Balance, December 31, 1997.....	1,171,906	5,860,000	77,000	1,895,000	(540,000)	7,292,000
Net income.....	--	--	--	789,000	--	789,000
ESOP shares committed to be released.....	--	--	65,000	--	108,000	173,000
Balance, December 31, 1998.....	1,171,906	\$ 5,860,000	\$ 142,000	\$ 2,684,000	\$ (432,000)	\$ 8,254,000
Net income (unaudited).....	--	--	--	131,000	--	131,000
ESOP shares committed to be released.....	--	--	27,000	--	27,000	54,000
Balance March 31, 1999 (unaudited).....	1,171,906	\$ 5,860,000	\$ 169,000	\$ 2,815,000	\$ (405,000)	\$ 8,439,000

</TABLE>

See Notes to Financial Statements.

F-38

VALLEY BANK

STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31, 1998, 1997 AND 1996  
AND THE THREE MONTHS ENDED 1999 AND 1998

<TABLE>

<CAPTION>

	THREE MONTHS ENDED				
	MARCH 31, (UNAUDITED)				
	1999	1998	1998	1997	1996
<S>	<C>	<C>	<C>	<C>	<C>
Cash Flows from Operating Activities					
Net income.....	\$ 131,000	\$ (9,000)	\$ 789,000	\$ 556,000	\$ 454,000
Adjustments to reconcile net income to net cash provided by operating activities:					
Depreciation and amortization.....	85,000	73,000	320,000	325,000	378,000
Provision for loan losses.....	90,000	150,000	200,000	980,000	360,000
Net amortization and accretion of bond premiums and discounts.....	8,000	8,000	(38,000)	6,000	125,000
Amortization of deferred gain on SBA loan sales...	(65,000)	(12,000)	(127,000)	(69,000)	(47,000)
Write-down of other real estate owned.....	--	--	58,000	64,000	119,000
Change in deferred taxes.....	--	--	(88,000)	(346,000)	(143,000)
ESOP shares committed to be released.....	27,000	1,000	173,000	71,000	13,000
Proceeds from sale of loans held for sale.....	2,779,000	--	14,626,000	12,059,000	7,725,000
Origination/transfer of loans held for sale.....	(2,302,000)	(3,147,000)	(13,851,000)	(10,111,000)	(7,532,000)
Loss on sale of bank premises and equipment.....	--	--	26,000	--	--
(Gain) on sale of loans held for sale.....	(220,000)	--	(1,057,000)	(772,000)	(375,000)
(Gain) loss on sale of other real estate owned....	--	--	8,000	(2,000)	244,000
(Increase) in interest receivable and other assets.....	120,000	(146,000)	(510,000)	(327,000)	(193,000)
Increase (decrease) in accrued interest and other liabilities.....	(27,000)	116,000	(218,000)	(98,000)	328,000
NET CASH PROVIDED BY OPERATING ACTIVITIES.....	624,000	(2,966,000)	311,000	2,336,000	1,456,000
Cash Flows from Investing Activities					
Purchase of securities held to maturity.....	(30,000,000)	(2,500,000)	(14,000,000)	(6,500,000)	(5,500,000)
Proceeds from maturities of securities held to maturity.....	21,500,000	2,946,000	12,309,000	5,566,000	7,550,000
Change in loans made to customers, net.....	13,000	(325,000)	1,748,000	(4,971,000)	(695,000)
Purchase of residential lot loans.....	--	--	(6,988,000)	--	--
Net (increase) decrease in federal funds sold.....	4,881,000	(1,446,000)	(8,980,000)	524,000	(222,000)
Proceeds from sale of bank premises and equipment...	--	--	5,000	--	56,000
Proceeds from sale of other real estate owned.....	--	--	555,000	277,000	156,000
Purchases of bank premises and equipment.....	(53,000)	(72,000)	(349,000)	(249,000)	(249,000)
NET CASH (USED IN) INVESTING ACTIVITIES.....	(3,659,000)	(1,397,000)	(8,712,000)	(5,353,000)	(5,892,000)

Cash Flows from Financing Activities					
Net increase in deposits.....	2,691,000	4,739,000	9,500,000	2,953,000	4,285,000
Dividends paid.....	--	--	--	(1,000)	--
Exercise of stock options.....	--	--	--	42,000	--
Principal payments on ESOP bank note payable.....	(30,000)	(16,000)	(101,000)	(26,000)	--
NET CASH PROVIDED BY FINANCING ACTIVITIES.....	2,661,000	4,723,000	9,399,000	2,968,000	4,285,000
INCREASE (DECREASE) IN CASH AND DUE FROM BANKS.....					
Cash and Due from Banks					
Beginning.....	6,485,000	5,487,000	5,487,000	5,536,000	5,687,000
Ending.....	\$ 6,111,000	\$ 5,847,000	\$ 6,485,000	\$ 5,487,000	\$ 5,536,000
Supplemental disclosures of cash flow information:					
Cash payments for:					
Interest.....	\$ 372,000	\$ 342,000	\$ 1,382,000	\$ 1,222,000	\$ 1,104,000
Income taxes paid.....	\$ --	\$ --	\$ 1,037,000	\$ 416,000	\$ 323,000
Supplemental schedule of noncash investing and financing activities:					
Issuance of ESOP notes payable to purchase Bank stock.....	\$ --	\$ --	\$ --	\$ 278,000	\$ 327,000
Other real estate acquired in settlement of loans...	\$ --	\$ --	\$ 710,000	\$ 906,000	\$ 108,000
Loans acquired in exchange for other real estate owned.....	\$ --	\$ --	\$ 50,000	\$ --	\$ 1,000,000
Stock dividend declared.....	\$ --	\$ --	\$ --	\$ 332,000	\$ --

</TABLE>

See Notes to Financial Statements

F-39

VALLEY BANK

NOTES TO FINANCIAL STATEMENTS

INFORMATION RELATING TO MARCH 31, 1999 IS UNAUDITED

NOTE 1. NATURE OF BANKING ACTIVITIES AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

NATURE OF OPERATIONS

Valley Bank (the Bank) provides a full range of banking services to its commercial and consumer customers through seven branches located in the Inland Empire and the low desert areas of Southern California and a lending office located in Portland, Oregon.

The Bank grants commercial, residential and consumer loans to customers, substantially all of whom are middle-market businesses or residents. The Bank's business is concentrated in the Inland Empire, the low desert area of Southern California and Portland, Oregon. The loan portfolio includes significant credit exposure to the real estate industry (commercial and residential) of these areas. As of December 31, 1998, real estate-related loans accounted for approximately 69% of total loans. Substantially all of these loans are secured by first liens with an initial loan-to-value ratio of generally not more than 70%. Less than 10% of commercial loans are unsecured. The loans are expected to be repaid from cash flows or proceeds from the sale of selected assets of the borrowers. The Bank's policy requires that collateral be obtained on substantially all loans. Such collateral is primarily first trust deeds on property.

USE OF ESTIMATES IN THE PREPARATION OF FINANCIAL STATEMENTS

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 disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting

period. Actual results could differ from those estimates.

#### CASH AND DUE FROM BANKS

For purposes of reporting cash flows, cash and due from banks includes cash on hand and amounts due from banks. Cash flows from loans originated by the Bank, deposits and federal funds sold are reported net.

The Bank maintains amounts due from banks which, at times, may exceed federally insured limits. The Bank has not experienced any losses in such accounts.

The Bank is required to maintain reserve balances in cash or on deposit with Federal Reserve Banks. The total of those reserve balances was approximately \$1,351,000 and \$1,197,000 as of December 31, 1998 and 1997, respectively.

#### SECURITIES HELD TO MATURITY

Securities classified as held to maturity are those debt securities the Bank has both the intent and ability to hold to maturity regardless of changes in market conditions, liquidity needs or changes in general economic conditions. These securities are carried at cost adjusted

F-40

VALLEY BANK

#### NOTES TO FINANCIAL STATEMENTS (CONTINUED)

INFORMATION RELATING TO MARCH 31, 1999 IS UNAUDITED

#### NOTE 1. NATURE OF BANKING ACTIVITIES AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

for amortization of premiums and accretion of discount, computed by the interest method over their contractual lives.

The sale of a security within three months of its maturity date or after at least 85% of the principal outstanding has been collected is considered a maturity for purposes of classification and disclosure.

#### LOANS

Loans are stated at the amount of unpaid principal, reduced by unearned fees and an allowance for loan losses.

The allowance for loan losses is established through a provision for loan losses charged to expense. Loans are charged against the allowance for loan losses when management believes that collectibility of the principal is unlikely. The allowance is an amount that management believes will be adequate to absorb estimated losses on existing loans that may become uncollectible, based on evaluation of the collectibility of loans and prior loan loss experience. This evaluation also takes into consideration such factors as changes in the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans and current economic conditions that may affect the borrower's ability to pay.

While management uses the best information available to make its evaluation, future adjustments to the allowance may be necessary if there are significant changes in economic or other conditions. In addition, the Federal Deposit Insurance Corporation (FDIC) and California Department of Financial Institutions, as an integral part of their examination process, periodically review the Bank's allowance for loan losses and may require the Bank to make additions to the allowance based on their judgment about information available to them at the time of their examinations.

A loan is impaired when it is probable the creditor will be unable to collect all contractual principal and interest payments due in accordance with the terms of the loan agreement. Impaired loans are measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or, as a practical expedient, at the loan's observable market price or the fair value of the collateral if the loan is collateral dependent. The amount of impairment, if any, and any subsequent changes are included in the allowance for loan losses.

#### INTEREST AND FEES ON LOANS

Interest on loans is recognized over the terms of the loans and is calculated using the simple-interest method on principal amounts outstanding. The accrual of interest on impaired loans is discontinued when, in management's opinion, the borrower may be unable to meet

F-41

## NOTES TO FINANCIAL STATEMENTS (CONTINUED)

INFORMATION RELATING TO MARCH 31, 1999 IS UNAUDITED

## NOTE 1. NATURE OF BANKING ACTIVITIES AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

payments as they become due. When the accrual of interest is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent cash payments are received.

Loan origination and commitment fees and certain direct loan origination costs are deferred and the net amount amortized as an adjustment of the related loan's yield. The Bank is generally amortizing these amounts over the contractual life.

## SALE OF LOANS

The Bank sells the guaranteed and unguaranteed portion of Small Business Administration (SBA) loans in the secondary market to provide funds for additional lending and to generate servicing income. Under such agreements, the Bank continues to service the loans and the buyer receives the principal collected together with interest. Loans held for sale are valued at the lower of cost or market value.

The Bank has issued various representations and warranties associated with the sale of loans. These representations and warranties may require the Bank to repurchase loans for a period of 90 days after the date of sale as defined per the applicable sales agreement. The Bank experienced no losses during the years ended December 31, 1998 and 1996 regarding these representations and warranties. Reference should be made to Note 8 for losses incurred in 1997.

The Bank serviced approximately \$28,594,000 and \$22,425,000 of loans for SBA as of December 31, 1998 and 1997, respectively, which are not included in the accompanying balance sheets (see Note 8).

## BANK PREMISES AND EQUIPMENT

Bank premises and equipment are stated at cost less accumulated depreciation and amortization. Depreciation is computed principally by the straight-line method over the estimated useful lives of the assets. Improvements to leased property are amortized over the lesser of the term of the lease or life of the improvements.

## OTHER REAL ESTATE OWNED

Other real estate owned (OREO) represents properties acquired through foreclosure or other proceedings. OREO is held for sale and is recorded at the lower of the carrying amounts of the related loans or the estimated fair value of the properties less estimated costs of disposal. Any write-down to estimated fair value less cost to sell at the time of transfer to OREO is charged to the allowance for loan losses. Property is evaluated regularly by management and reduction of the carrying amounts to estimated fair value less estimated costs to

F-42

## NOTES TO FINANCIAL STATEMENTS (CONTINUED)

INFORMATION RELATING TO MARCH 31, 1999 IS UNAUDITED

## NOTE 1. NATURE OF BANKING ACTIVITIES AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

dispose are recorded as necessary. Revenue and expense from the operations of OREO and changes in the valuation allowance are included in expenses.

## INCOME TAXES

Deferred taxes are provided on a liability method whereby deferred tax assets are recognized for deductible temporary differences and operating loss and tax credit carryforwards and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax bases. Deferred tax assets are reduced by a valuation allowance when management determines that it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

## FAIR VALUE OF FINANCIAL INSTRUMENTS

Management uses its best judgment in estimating the fair value of the Bank's

financial instruments; however, there are inherent weaknesses in any estimation technique. Therefore, for substantially all financial instruments, the fair value estimates presented herein are not necessarily indicative of the amounts the Bank could have realized in a sales transaction at December 31, 1998 or 1997. The estimated fair value amounts for 1998 and 1997 have been measured as of year end, and have not been reevaluated or updated for purposes of these financial statements subsequent to that date. As such, the estimated fair values of these financial instruments subsequent to the reporting date may be different than the amounts reported at year end.

The information in Note 13 should not be interpreted as an estimate of the fair value of the entire Bank since a fair value calculation is only required for a limited portion of the Bank's assets.

Due to the wide range of valuation techniques and the degree of subjectivity used in making the estimate, comparisons between the Bank's disclosures and those of other banks may not be meaningful.

The following methods and assumptions were used by the Bank in estimating the fair value of its financial instruments:

#### CASH

The carrying amounts reported in the balance sheets for cash and due from banks and federal funds sold approximate their fair value.

F-43

VALLEY BANK

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

INFORMATION RELATING TO MARCH 31, 1999 IS UNAUDITED

NOTE 1. NATURE OF BANKING ACTIVITIES AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

#### SECURITIES

Fair value for securities held to maturity is based on quoted market prices.

#### LOANS

For variable rate loans that reprice frequently and that have experienced no significant change in credit risk, fair value is based on carrying value. At December 31, 1998 and 1997, variable rate loans comprised approximately 90% and 86%, respectively, of the loan portfolio. Fair value for all other loans is estimated based on discounted cash flows, using interest rates currently being offered for loans with similar terms to borrowers with similar credit quality. Prepayments prior to the repricing date are not expected to be significant. Loans are expected to be held to maturity and any unrealized gains or losses are not expected to be realized.

#### LOANS HELD FOR SALE

Fair value is based on quoted market prices of similar loans sold on the secondary market.

#### OFF-BALANCE-SHEET INSTRUMENTS

Fair value for off-balance-sheet instruments (guarantees, letters of credit and lending commitments) is based on quoted fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing.

#### DEPOSIT LIABILITIES

Fair value disclosed for demand deposits equals their carrying amounts, which represent the amount payable on demand. The carrying amounts for variable rate money market accounts and certificates of deposit approximate their fair values at the reporting date. Fair value for fixed rate certificates of deposit is estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregate expected monthly maturities on time deposits. Early withdrawal of fixed rate certificates of deposit are not expected to be significant.

#### ACCRUED INTEREST RECEIVABLE AND PAYABLE

The fair value of both accrued interest receivable and payable approximates their carrying amounts.

F-44

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

INFORMATION RELATING TO MARCH 31, 1999 IS UNAUDITED

NOTE 1. NATURE OF BANKING ACTIVITIES AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

ESOP BANK NOTES PAYABLE

The fair value of the ESOP bank notes payable approximates their carrying amounts.

OTHER OFF-BALANCE-SHEET INSTRUMENTS

In the ordinary course of business, the Bank has entered into off-balance-sheet financial instruments consisting of commitments to extend credit, commercial letters of credit and standby letters of credit. Such financial instruments are recorded in the financial statements when they are funded.

EARNINGS PER SHARE

Components used in computing earnings per share (EPS) for the three months ended March 31, 1999 and 1998 and the years ended December 31 are as follows:

<TABLE>  
<CAPTION>

	MARCH 31,					
	1999			1998		
	INCOME (NUMER- ATOR)	SHARES (DENOMI- NATOR)	PER- SHARE AMOUNT	INCOME (NUMER- ATOR)	SHARES (DENOMI- NATOR)	PER- SHARE AMOUNT
<S>	<C>	<C>	<C>	<C>	<C>	<C>
BASIC EPS						
Income available to common stockholders.....	\$ 131,000	1,089,588	\$ 0.12	\$ (9,000)	1,084,112	\$ (0.01)
EFFECT OF DILUTIVE SECURITIES						
Options.....	--	129,740		--	--	
DILUTED EPS						
Income available to common stockholders + assumed conversions.....	\$ 131,000	1,219,328	\$ 0.11	\$ (9,000)	1,084,112	\$ (0.01)

</TABLE>

<TABLE>

<CAPTION>

	1998			1997			1996	
	INCOME (NUMER- ATOR)	SHARES (DENOMI- NATOR)	PER- SHARE AMOUNT	INCOME (NUMER- ATOR)	SHARES (DENOMI- NATOR)	PER- SHARE AMOUNT	INCOME (NUMER- ATOR)	SHARES (DENOMI- NATOR)
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
BASIC EPS								
Income available to common stockholders.....	\$ 789,000	1,084,112	\$ 0.73	\$ 556,000	1,055,293	\$ 0.53	\$ 454,000	1,094,211
EFFECT OF DILUTIVE SECURITIES								
Options.....	--	129,740		--	42,151		--	23,543
DILUTED EPS								
Income available to common stockholders + assumed conversions.....	\$ 789,000	1,213,852	\$ 0.65	\$ 556,000	1,097,444	\$ 0.51	\$ 454,000	1,117,754

<CAPTION>

	PER- SHARE AMOUNT
<S>	<C>
BASIC EPS	
Income available to common stockholders.....	\$ 0.41
EFFECT OF DILUTIVE SECURITIES	
Options.....	

DILUTED EPS	
Income available to common stockholders + assumed conversions.....	\$ 0.41

</TABLE>

F-45

VALLEY BANK

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

INFORMATION RELATING TO MARCH 31, 1999 IS UNAUDITED

NOTE 1. NATURE OF BANKING ACTIVITIES AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The average number of common shares outstanding excludes 87,794, 109,410 and 69,823 shares owned by the Employee Stock Ownership Plan (ESOP) that have not been committed to be released as of December 31, 1998, 1997 and 1996, respectively. See Note 9 for further information regarding the shares owned by the ESOP.

CURRENT ACCOUNTING DEVELOPMENTS

In June 1998, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 133, ACCOUNTING FOR DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES. This Statement establishes accounting and reporting standards for derivative instruments and for hedging activities. This new standard is effective for the year 2000 and is not expected to have a material impact on the financial statements of the Bank.

In October 1998, the FASB issued SFAS No. 134, ACCOUNTING FOR MORTGAGE-BACKED SECURITIES RETAINED AFTER THE SECURITIZATION OF MORTGAGE LOANS HELD FOR SALE BY A MORTGAGE BANKING ENTERPRISE (AN AMENDMENT OF FASB STATEMENT NO. 65). This Statement establishes accounting and reporting standards for certain activities of mortgage banking enterprises and other enterprises that conduct operations that are substantially similar to the primary operations of a mortgage banking enterprise. Statement No. 134 will be effective for the first fiscal quarter beginning after December 15, 1998. The Bank does not engage in mortgage banking activities.

RECLASSIFICATIONS

Certain amounts in the prior year's financial statements and related footnote disclosures were reclassified to conform to the current year presentation, with no effect on net income or stockholders' equity.

INTERIM FINANCIAL INFORMATION (UNAUDITED)

The financial statements and notes related thereto as of March 31, 1999 and 1998 and for the three-month periods ended March 31, 1999 and 1998 are unaudited. In the opinion of management, the interim financial statements are prepared on a basis consistent with the Company's annual financial statements and include all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the financial position and results of operations. The operating results for the interim periods are not indicative of the operating results to be expected for a full year or for other interim periods. Not all disclosures required by generally accepted accounting principles necessary for a complete presentation have been included.

F-46

VALLEY BANK

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

INFORMATION RELATING TO MARCH 31, 1999 IS UNAUDITED

NOTE 2. SECURITIES

Carrying amounts and fair value of securities being held to maturity as of March 31, 1999 and December 31 are summarized as follows:

<TABLE>  
<CAPTION>

	1999			
	AMORTIZED COST	UNREALIZED GAINS	UNREALIZED LOSSES	FAIR VALUE
<S>	<C>	<C>	<C>	<C>



U.S. Treasury securities and obligations of other U.S. government corporations and agencies.....	\$ 23,496,000	\$ --	\$ (9,000)	\$ 23,487,000
Municipal obligations.....	581,000	16,000	--	597,000
	\$ 24,077,000	\$ 16,000	\$ (9,000)	\$ 24,084,000

</TABLE>

<TABLE>  
<CAPTION>

	1998			
	AMORTIZED COST	UNREALIZED GAINS	UNREALIZED LOSSES	FAIR VALUE
<S>	<C>	<C>	<C>	<C>
U.S. Treasury securities and obligations of other U.S. government corporations and agencies.....	\$ 15,004,000	\$ 39,000	\$ (1,000)	\$ 15,042,000
Municipal obligations.....	581,000	19,000	--	600,000
	\$ 15,585,000	\$ 58,000	\$ (1,000)	\$ 15,642,000

</TABLE>

<TABLE>  
<CAPTION>

	1997			
	AMORTIZED COST	UNREALIZED GAINS	UNREALIZED LOSSES	FAIR VALUE
<S>	<C>	<C>	<C>	<C>
U.S. Treasury securities and obligations of other U.S. government corporations and agencies.....	\$ 11,957,000	\$ 39,000	\$ (4,000)	\$ 11,992,000
Mortgage-backed securities.....	781,000	1,000	--	782,000
Municipal obligations.....	1,118,000	37,000	(9,000)	1,146,000
	\$ 13,856,000	\$ 77,000	\$ (13,000)	\$ 13,920,000

</TABLE>

The amortized cost and fair value of investment securities as of March 31, 1999 by contractual maturities are shown below.

<TABLE>  
<CAPTION>

	AMORTIZED COST	FAIR VALUE
<S>	<C>	<C>
Due in one year or less.....	\$ 16,142,000	\$ 16,146,000
Due after one year through five years.....	7,935,000	7,938,000
	\$ 24,077,000	\$ 24,084,000

</TABLE>

Securities being held to maturity with carrying amounts of \$6,585,000 and \$8,070,000 at December 31, 1998 and 1997, respectively, were pledged as collateral on public deposits, repurchase agreements and for other purposes as required or permitted by law.

F-47

VALLEY BANK

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

INFORMATION RELATING TO MARCH 31, 1999 IS UNAUDITED

NOTE 3. LOANS

The composition of the Bank's loan portfolio as of March 31, 1999 and December 31, 1998 and 1997 is as follows:

<TABLE>  
<CAPTION>

	1999	1998	1997
<S>	<C>	<C>	<C>

Real estate loans:			
Construction.....	\$ 7,395,000	\$ 6,733,000	\$ 6,873,000
Residential.....	4,716,000	4,848,000	7,116,000
Unimproved residential lots.....	4,476,000	4,898,000	6,369,000
Commercial.....	14,968,000	13,910,000	14,535,000
	-----	-----	-----
	31,555,000	30,389,000	34,893,000
Commercial and industrial loans.....	2,031,000	2,653,000	1,746,000
Government guaranteed loans.....	8,636,000	9,173,000	8,377,000
Loans to individuals.....	401,000	504,000	435,000
	-----	-----	-----
	42,623,000	42,719,000	45,451,000
Deduct:			
Unearned net loan fees and discounts.....	174,000	164,000	191,000
Allowance for loan losses.....	1,115,000	1,118,000	1,058,000
	-----	-----	-----
	\$ 41,334,000	\$ 41,437,000	\$ 44,202,000
	-----	-----	-----

</TABLE>

#### IMPAIRED LOANS

Information about impaired loans as of and for the years ended December 31 is as follows:

		1998	1997
		-----	-----
<S>	<C>	<C>	<C>
Impaired loans for which there is a related allowance for loan losses.....		\$ 3,934,000	\$ 1,763,000
		-----	-----
Related allowance for loan losses.....		\$ 502,000	\$ 317,000
		-----	-----
Average balance (based on month-end balances).....		\$ 2,644,000	\$ 1,447,000
		-----	-----
Interest income recognized.....		\$ --	\$ --
		-----	-----

</TABLE>

The Bank is not committed to lend additional funds to debtors whose loans have been modified due to an impairment.

The Bank had nonaccrual loans of \$4,827,000 and \$3,227,000 as of December 31, 1998 and 1997, respectively. Interest income that would have been earned on such nonaccrual loans, had such loans performed according to their loan terms, would have been \$424,000,

F-48

VALLEY BANK

#### NOTES TO FINANCIAL STATEMENTS (CONTINUED)

INFORMATION RELATING TO MARCH 31, 1999 IS UNAUDITED

#### NOTE 3. LOANS (CONTINUED)

\$147,000 and \$307,000 in 1998, 1997 and 1996, respectively. Management estimates that certain nonaccrual loans, which are not classified as impaired, will ultimately be collected in full in accordance with the original terms.

#### LOANS HELD FOR SALE

Information about loans held for sale as of and for the years ended December 31 is as follows:

		1998	1997
		-----	-----
<S>	<C>	<C>	<C>
Balance, beginning.....		\$ --	\$ 670,000
Loans transferred from loan portfolio.....		13,851,000	10,111,000
Loans sold.....		(13,257,000)	(10,781,000)
		-----	-----
Balance, ending.....		\$ 594,000	\$ --

</TABLE>

There were no outstanding commitments to sell loans at December 31, 1997.

NOTE 4. ALLOWANCE FOR LOAN LOSSES

Changes in the allowance for loan losses for the three months ended March 31, 1999 and 1998, and the years ended December 31, 1998, 1997 and 1996 are as follows:

<TABLE>  
<CAPTION>

	MARCH 31,		DECEMBER 31,		
	1999	1998	1998	1997	1996
<S>	<C>	<C>	<C>	<C>	<C>
Balance, beginning.....	\$ 1,118,000	\$ 1,105,000	\$ 1,058,000	\$ 756,000	\$ 497,000
Provision charged to operating expense....	90,000	150,000	200,000	980,000	360,000
Recoveries of amounts charged off.....	6,000	41,000	272,000	81,000	20,000
Amounts charged off.....	(99,000)	(97,000)	(412,000)	(759,000)	(121,000)
Balance, ending.....	\$ 1,115,000	\$ 1,152,000	\$ 1,118,000	\$ 1,058,000	\$ 756,000

</TABLE>

F-49

VALLEY BANK

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

INFORMATION RELATING TO MARCH 31, 1999 IS UNAUDITED

NOTE 5. BANK PREMISES AND EQUIPMENT

The major classes of bank premises and equipment and the total accumulated depreciation and amortization as of December 31 are as follows:

<TABLE>  
<CAPTION>

	1998	1997
<S>	<C>	<C>
Land.....	\$ 579,000	\$ 579,000
Buildings and leasehold improvements.....	2,259,000	2,309,000
Equipment and furnishings.....	2,322,000	2,611,000
Construction in progress.....	31,000	52,000
	5,191,000	5,551,000
Less accumulated depreciation and amortization.....	3,033,000	3,391,000
	\$ 2,158,000	\$ 2,160,000

</TABLE>

NOTE 6. DEPOSITS

The aggregate amount of jumbo certificates of deposit, each with a minimum denomination of \$100,000, was approximately \$2,443,000 and \$2,103,000 in 1998 and 1997, respectively. Substantially all certificates of deposit mature in the year ending December 31, 1999.

NOTE 7. INCOME TAXES

The cumulative tax effects of temporary differences as of December 31 are shown in the following table:

<TABLE>  
<CAPTION>

	1998	1997
<S>	<C>	<C>
Deferred tax assets:		
Credit loss allowance.....	\$ 189,000	\$ 149,000
Deferred loan fees.....	73,000	86,000
Other real estate owned.....	26,000	29,000
Nonaccrual interest.....	44,000	26,000
Gain recognized on sale of loans.....	409,000	380,000
Other.....	30,000	--

Total deferred tax assets.....	771,000	670,000
Deferred tax liabilities:		
Property and equipment.....	41,000	17,000
Other.....	--	11,000
Total deferred tax liabilities.....	41,000	28,000
Net deferred tax asset.....	\$ 730,000	\$ 642,000

</TABLE>

At December 31, 1998, no valuation reserve was considered necessary as management believes it is more likely than not that the deferred tax assets will be realized due to taxes paid in prior years or future operations.

F-50

VALLEY BANK

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

INFORMATION RELATING TO MARCH 31, 1999 IS UNAUDITED

NOTE 7. INCOME TAXES (CONTINUED)

The provision for income taxes charged to operations for the years ended December 31 consists of the following:

<TABLE>

<CAPTION>

	1998	1997	1996
<S>	<C>	<C>	<C>
Current tax expense.....	\$ 672,000	\$ 588,000	\$ 472,000
Deferred tax (benefit).....	(88,000)	(346,000)	(143,000)
	\$ 584,000	\$ 242,000	\$ 329,000

</TABLE>

The income tax provision differs from the amount of income tax determined by applying the U.S. federal income tax rate to pretax income for the years ended December 31 as follows:

<TABLE>

<CAPTION>

	1998	1997	1996
<S>	<C>	<C>	<C>
Computed "expected" tax expense.....	\$ 481,000	\$ 279,000	\$ 274,000
Increase (decrease) in income taxes resulting from:			
State income taxes, net of federal tax benefit.....	98,000	58,000	55,000
Change in valuation allowance.....	--	(134,000)	--
Other.....	5,000	39,000	--
	\$ 584,000	\$ 242,000	\$ 329,000

</TABLE>

NOTE 8. COMMITMENTS AND CONTINGENCIES

CONTINGENCIES

In the normal course of business, the Bank is involved in various legal proceedings. In the opinion of management, any liability resulting from such proceedings would not have a material adverse effect on the financial statements.

In the normal course of business, the Bank makes loans which are partially guaranteed by third parties, primarily the SBA. These guarantees are conditional upon satisfactory underwriting and loan monitoring standards which are agreed upon in advance by both parties. During the year ended December 31, 1997, the Bank experienced a loss of approximately \$380,000 on a loan on which the SBA did not honor its guarantee due to unsatisfactory underwriting standards. The Bank's existing loan portfolio contains approximately \$28,594,000 of loans serviced for others, of which \$26,794,000 are guaranteed by the governmental agencies, and excluded from the accompanying balance sheet. The Bank's management believes it is generally in compliance with the required underwriting and loan monitoring standards.

The Bank is party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments

F-51

## VALLEY BANK

## NOTES TO FINANCIAL STATEMENTS (CONTINUED)

INFORMATION RELATING TO MARCH 31, 1999 IS UNAUDITED

## NOTE 8. COMMITMENTS AND CONTINGENCIES (CONTINUED)

include commitments to extend credit and standby letters of credit. They involve, to varying degrees, elements of credit risk in excess of amounts recognized on the balance sheets.

The Bank's exposure to credit loss in the event of nonperformance by the other parties to the financial instruments for these commitments is represented by the contractual amounts of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

A summary of the contract amount of the Bank's exposure to off-balance-sheet risk as of December 31 is as follows:

	1998	1997
	-----	-----
<S>		
<C>		
Commitments to extend credit, including unsecured loan commitments of 1998 \$368,000; 1997 \$167,000.....	\$ 2,582,000	\$ 6,664,000
Standby letters of credit.....	178,000	212,000
	-----	-----
	\$ 2,760,000	\$ 6,876,000
	-----	-----
	-----	-----

&lt;/TABLE&gt;

## COMMITMENTS TO EXTEND 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 amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis. If deemed necessary upon extension of credit, the amount of collateral obtained is based on management's credit evaluation of the counterparty. Collateral held varies but may include accounts receivable, inventory, property and equipment, and income-producing commercial properties.

## STANDBY LETTERS OF CREDIT

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Collateral held varies as specified above and is required in instances which the Bank deems necessary. At December 31, 1998, approximately 17% of the standby letters of credit were collateralized.

F-52

## VALLEY BANK

## NOTES TO FINANCIAL STATEMENTS (CONTINUED)

INFORMATION RELATING TO MARCH 31, 1999 IS UNAUDITED

## NOTE 8. COMMITMENTS AND CONTINGENCIES (CONTINUED)

## INTEREST RATE RISK

The Bank assumes interest rate risk (the risk that general interest rate levels will change) as a result of its normal operations. Management attempts to match maturities of assets and liabilities to the extent believed necessary to minimize interest rate risk. However, borrowers with fixed rate obligations are more likely to prepay in a falling rate environment and less likely to prepay in a rising rate environment. Conversely, depositors who are receiving fixed rates

are more likely to withdraw funds before maturity in a rising rate environment and less likely to do so in a falling rate environment. Management monitors rates and maturities of assets and liabilities and attempts to minimize interest rate risk by adjusting terms of new loans and deposits and by investing in securities with terms that mitigate the Bank's overall interest rate risk.

LEASE COMMITMENTS

The Bank leases the facilities for two of its branch offices and its Data Processing Center under noncancelable operating lease agreements expiring through the year 2000. The leases contain renewal options of various five- and ten-year terms with various rental increases based on the Consumer Price Index. In addition, the Bank has the option to purchase the Perris branch property at certain agreed-upon terms. The leases require the Bank to pay property taxes, utilities, insurance and normal maintenance on the premises. The following is a schedule of future minimum rental payments under this lease:

YEARS ENDING DECEMBER 31,	AMOUNT
1999.....	\$ 53,000
2000.....	6,000
	-----
	\$ 59,000
	-----
	-----

</TABLE>

Total rent expense under these leases for the years ended December 31, 1998, 1997 and 1996 was \$101,000, \$99,000 and \$80,000, respectively.

FINANCIAL INSTRUMENTS WITH CONCENTRATION OF CREDIT RISK

CONCENTRATION BY GEOGRAPHIC LOCATION: The Bank makes commercial, residential and consumer loans to customers primarily in the Inland Empire, the low desert areas of Southern California and in Portland, Oregon. In addition, the Bank has a concentration of residential lot loans located in Fort Mojave, Arizona.

A substantial portion of the Bank's customers' abilities to honor their contracts is dependent on the business economy in the Inland Empire, low desert areas of Southern California, its surrounding areas, Portland, Oregon, and Fort Mojave, Arizona.

F-53

VALLEY BANK

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

INFORMATION RELATING TO MARCH 31, 1999 IS UNAUDITED

NOTE 8. COMMITMENTS AND CONTINGENCIES (CONTINUED)

CONCENTRATION BY INDUSTRY: The loan portfolio has a concentration of loans related to real estate, primarily loans for commercial and residential operations. These concentrations are reflected in Note 3 to these financial statements.

COMMITMENT TO IMPROVE FINANCIAL CONDITION

In response to an examination by the Federal Deposit Insurance Corporation in February 1998, the Board of Directors passed a resolution to increase the Bank's earnings and reduce adversely classified assets. As a result of the Bank's efforts in these areas, earnings after tax increased from \$556,000 in 1997 to \$860,000 in 1998. Adversely classified assets as a percentage of Tier 1 capital plus loan loss reserves were reduced from 43.7% in 1997 to 15.4% in 1998. In addition, the resolution addressed certain commitments regarding Year 2000 compliance issues.

NOTE 9. EMPLOYEE BENEFIT PLANS

EMPLOYEE BONUS PLAN

The Bank has an employee bonus plan for all employees. Employee bonuses are based on a percentage of beginning equity ranging from 6% to 20% depending upon the level of the Bank's profitability for the year. Total disbursements to employees were \$146,000, \$54,000 and \$29,000 for the years ended December 31, 1998, 1997 and 1996, respectively.

PROFIT SHARING/SALARY DEFERRAL PLAN

The Bank has a salary deferral 401(k) plan for all employees who have completed one year and 1,000 hours of service. Annual contributions are limited to the maximum deductible percentage of covered employee compensation. The Bank contributes matching funds at its option which amounted to \$99,000, \$71,000 and \$76,000 in 1998, 1997 and 1996, respectively.

STOCK PURCHASE PLAN

The Bank offered a stock purchase plan to eligible officers and employees, which was terminated in 1998. The plan provided for a voluntary payroll deduction on the part of the eligible officer or employee up to 15% of their gross salary. The amount of funds set aside was used to purchase Bank stock as it became available on the open market. The Bank has agreed to supplement up to 25% of the payroll deduction by a contribution to this plan. Contributions for this plan amounted to \$5,000, \$6,000 and \$5,000 in 1998, 1997 and 1996, respectively.

SALARY CONTINUATION PLAN

In April 1995, the Board of Directors authorized the Bank to enter an agreement with the Bank's president to provide for annual cash payments to the officer for a period not to

F-54

VALLEY BANK

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

INFORMATION RELATING TO MARCH 31, 1999 IS UNAUDITED

NOTE 9. EMPLOYEE BENEFIT PLANS (CONTINUED)

exceed 15 years, beginning at his normal retirement age (age 65). In the event of death prior to normal retirement age, annual cash payments would be made to beneficiaries for a period of ten years following the date of death. The present value of the Bank's liability under this agreement was approximately \$160,000 and \$109,000 at December 31, 1998 and 1997, respectively. The Bank purchased life insurance policies in 1995 which are intended to ultimately fund all costs of this agreement. The cash surrender value related to these insurance policies was approximately \$712,000 and \$661,000 at December 31, 1998 and 1997, respectively.

CONTINGENCY CONTRACTS

Certain officers of the Bank have contingency contracts which provide for benefits upon termination or in the event the Bank experiences a merger, acquisition or other act.

EMPLOYEE STOCK OWNERSHIP PLAN

The Bank sponsors a leveraged ESOP covering substantially all employees. Contributions to the ESOP are at the discretion of the Board of Directors. The Bank makes annual contributions to the ESOP equal to the ESOP's debt service less dividends received by the ESOP, if any. The ESOP shares initially were pledged as collateral for the debt. As the debt is repaid, shares are released from collateral and allocated to active employees, based on the proportion of debt service paid in the year. The debt of the ESOP is recorded as debt and the shares pledged as collateral are deducted from stockholders' equity as unearned ESOP shares in the accompanying balance sheets.

The notes payable referred to in the preceding paragraph require annual principal payments plus interest at rates ranging from 1% to 1.25% over the reference rate (7.75% at December 31, 1998). Future principal payments are due as follows:

YEARS ENDING DECEMBER 31,	AMOUNT
-----	
<S>	<C>
1999.....	\$ 118,000
2000.....	120,000
2001.....	122,000
2002.....	93,000
2003.....	25,000
	-----
	\$ 478,000
	-----
	-----

</TABLE>

The ESOP did not purchase any shares of the Bank's common stock for the year ended of December 31, 1998 and purchased a total of 118,214 shares of the Bank's common stock through December 31, 1997. The ESOP financed a portion of the

purchase price by issuing notes payable which are guaranteed by the Bank.

F-55

VALLEY BANK

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

INFORMATION RELATING TO MARCH 31, 1999 IS UNAUDITED

NOTE 9. EMPLOYEE BENEFIT PLANS (CONTINUED)

As shares are released from collateral, the Bank reports compensation expense equal to management's estimate of the fair value price of the shares, and the shares become outstanding for EPS computations. ESOP compensation expense was \$173,000, \$71,000 and \$13,000 for the years ended December 31, 1998, 1997 and 1996, respectively.

In the event a terminated ESOP participant desires to sell his or her shares of the Bank's stock, the Bank may be required to purchase the shares from the participant at their fair market value.

Shares of the Bank held by the ESOP at December 31 are as follows:

<TABLE>  
<CAPTION>

	NUMBER OF SHARES	
	1998	1997
<S>	<C>	<C>
Allocated shares.....	13,842	2,280
Shares released for allocation.....	21,616	11,562
Unreleased (unearned) shares.....	87,794	109,410
	123,252	123,252

</TABLE>

At December 31, 1998, based on management's estimate, the fair value of the shares allocated and released for allocation amounted to \$284,000 and the fair value of the unreleased shares amounted to \$702,000.

NOTE 10. RELATED PARTY TRANSACTIONS

Stockholders of the Bank, and officers and directors, including their families and companies of which they are principal owners, are considered to be related parties. These related parties were loan customers of, and had other transactions with, the Bank in the ordinary course of business. In management's opinion, these loans and transactions were on the same terms as those for comparable loans and transactions with nonrelated parties.

Total loans to related parties were approximately \$65,000 at December 31, 1998. None of these loans are past due, nonaccrual or restructured to provide a reduction or deferral of interest or principal because of deterioration in the financial position of borrower. There were no loans to a related party which were considered classified loans at December 31, 1998. There were no related party loans at December 31, 1997.

NOTE 11. RESTRICTIONS ON RETAINED EARNINGS AND REGULATORY MATTERS

In October 1998, the Bank's Board of Directors adopted a resolution with certain compliance criteria of the California Department of Financial Institutions and the FDIC which

F-56

VALLEY BANK

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

INFORMATION RELATING TO MARCH 31, 1999 IS UNAUDITED

NOTE 11. RESTRICTIONS ON RETAINED EARNINGS AND REGULATORY MATTERS (CONTINUED)

replaced the resolution dated June 1996. The Bank's Board of Directors' resolution requires the Bank to perform the following:

- Develop, approve and submit a formal written testing plan to the FDIC by January 10, 1999 in full compliance with the Interagency Guidance of Testing for Year 2000 Readiness.
- Complete testing of its mission-critical systems by March 31, 1999.
- Maintain qualified senior management and notify the FDIC when they propose



to add an individual to the Board of Directors or to the senior management of the Bank.

- Provide quarterly progress reports to the FDIC.

In addition, the Bank fulfilled or complied with the following resolutions as of December 31, 1998:

- Corrected all data processing deficiencies identified in the April 1, 1998 Report of Examination of Information Systems.
- Revised, adopted and implemented written lending and collection policies to provide effective guidance and control over the Bank's lending function.
- Established asset quality improvement plans and goals for the reduction of each classified loan and parcel of OREO over \$50,000.
- Revised, adopted and implemented a plan to improve earnings, including a formal budget for 1999
- Adopt procedures to ensure future compliance with all applicable laws and regulations.
- Maintain Tier I capital of at least 8.0% of the Bank's adjusted total assets.

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory--and possibly additional discretionary--actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve qualitative measures of the Bank's assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

As of December 31, 1998, the most recent notification from the FDIC categorized the Bank as adequately capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier I risk-based and Tier I leverage ratios as set forth in the table below. There are no conditions or events since that notification that management believes have changed the Bank's category.

F-57

VALLEY BANK

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

INFORMATION RELATING TO MARCH 31, 1999 IS UNAUDITED

NOTE 11. RESTRICTIONS ON RETAINED EARNINGS AND REGULATORY MATTERS (CONTINUED)

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital (as defined) to average assets (as defined). Management believes, as of December 31, 1998, that the Bank meets all capital adequacy requirements to which it is subject.

At March 31, 1999 and December 31, 1998 and 1997, the Bank's actual capital amounts and ratios are presented in the following table:

<TABLE>

<CAPTION>

	ACTUAL		
	AMOUNT	RATIO	
<S>	<C>	<C>	<C>
As of March 31, 1999:			
Total capital (to risk-weighted assets)....	\$9,143,000	16.4%	Greater than or equal to
Tier I capital (to risk-weighted assets)...	8,439,000	15.1	Greater than or equal to
Tier I capital (to average assets).....	8,439,000	9.7	Greater than or equal to
As of March 31, 1998:			
Total capital (to risk-weighted assets)....	8,033,000	13.9	Greater than or equal to
Tier I capital (to risk-weighted assets)...	7,307,000	12.8	Greater than or equal to
Tier I capital (to average assets).....	7,307,000	9.4	Greater than or equal to
As of December 31, 1998:			
Total capital (to risk-weighted assets)....	\$8,927,000	16.7%	Greater than or equal to
Tier I capital (to risk-weighted assets)...	8,254,000	15.5	Greater than or equal to
Tier I capital (to average assets).....	8,254,000	10.2	Greater than or equal to
As of December 31, 1997:			

Total capital (to risk-weighted assets)....	7,981,000	14.5	Greater than or equal to
Tier I capital (to risk-weighted assets)...	7,292,000	13.5	Greater than or equal to
Tier I capital (to average assets).....	7,292,000	9.8	Greater than or equal to

<CAPTION>

	FOR CAPITAL ADEQUACY PURPOSES			TO BE WELL CAPITALIZED UNDER PROMPT CORRECTIVE ACTION PROVISIONS	
	AMOUNT	RATIO		AMOUNT	RATIO
	-----	-----	-----	-----	-----
<S>	<C>	<C>	<C>	<C>	<C>
As of March 31, 1999:					
Total capital (to risk-weighted assets)....	\$4,473,000	8.0%	Greater than or equal to	\$5,591,000	10.0%
Tier I capital (to risk-weighted assets)...	2,236,000	4.0	Greater than or equal to	3,355,000	6.0
Tier I capital (to average assets).....	3,470,000	4.0	Greater than or equal to	4,337,000	5.0
As of March 31, 1998:					
Total capital (to risk-weighted assets)....	4,553,000	8.0	Greater than or equal to	5,691,000	10.0
Tier I capital (to risk-weighted assets)...	2,276,000	4.0	Greater than or equal to	3,414,000	6.0
Tier I capital (to average assets).....	3,099,000	4.0	Greater than or equal to	3,874,000	5.0
As of December 31, 1998:					
Total capital (to risk-weighted assets)....	\$4,270,000	8.0%	Greater than or equal to	\$5,338,000	10.0%
Tier I capital (to risk-weighted assets)...	2,135,000	4.0	Greater than or equal to	3,203,000	6.0
Tier I capital (to average assets).....	3,250,000	4.0	Greater than or equal to	4,062,000	5.0
As of December 31, 1997:					
Total capital (to risk-weighted assets)....	4,383,000	8.0	Greater than or equal to	5,479,000	10.0
Tier I capital (to risk-weighted assets)...	2,164,000	4.0	Greater than or equal to	3,264,000	6.0
Tier I capital (to average assets).....	2,977,000	4.0	Greater than or equal to	3,721,000	5.0

</TABLE>

F-58

VALLEY BANK

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

INFORMATION RELATING TO MARCH 31, 1999 IS UNAUDITED

NOTE 12. STOCK OPTION PLANS

EMPLOYEES' INCENTIVE STOCK OPTION PLAN

The Bank maintains a compensatory incentive stock option plan in which options to purchase shares of the Bank's common stock are granted at the Board of Directors' discretion to certain management and other key personnel. The plan was originally established for a maximum of 240,000 shares (264,600 after stock dividends) of the Bank's common stock. Additional shares were authorized and granted as a result of stock dividends in subsequent years. All options expire ten years from date of grant and vest over a five-year period with 20% in each year. Upon certain change of control events, these options will become fully vested. Other pertinent information relating to the plan follows:

<TABLE>

<CAPTION>

	1998		1997		1996	
	NUMBER OF SHARES	WEIGHTED AVERAGE PRICE	NUMBER OF SHARES	WEIGHTED AVERAGE PRICE	NUMBER OF SHARES	WEIGHTED AVERAGE PRICE
	-----	-----	-----	-----	-----	-----
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Outstanding, beginning of year.....	189,834	\$ 5.49	161,750	\$ 5.40	141,750	\$ 5.63
Granted.....	--	--	20,000	6.25	20,000	3.75
5% stock dividend.....	--	--	8,084	5.40	--	--
Outstanding, end of year....	189,834	5.49	189,834	5.49	161,750	5.40
Exercisable, end of year....	143,595	5.62	123,270	5.71	85,050	5.83

</TABLE>

Additional option information for the year ended December 31, 1998 is as follows:

<TABLE>

<CAPTION>

WEIGHTED AVERAGE	WEIGHTED AVERAGE CONTRACTUAL	WEIGHTED AVERAGE
------------------	------------------------------	------------------

PRICE RANGE	OUTSTANDING	PRICE	LIFE IN YEARS	EXERCISABLE	PRICE
<S>	<C>	<C>	<C>	<C>	<C>
\$3.75-\$5.375.....	81,634	\$ 4.75	6.1	51,395	\$ 4.91
\$6.00-\$6.25.....	108,200	6.05	4.7	92,200	6.01
	189,834	\$ 5.49	5.3	143,595	\$ 5.62

</TABLE>

DIRECTORS' STOCK OPTION PLAN

In March 1994, the Bank's stockholders approved the 1993 Directors' Option Plan. This is a compensatory incentive stock option plan in which options to purchase shares of the Bank's common stock are granted at the discretion of the Board of Directors or a committee appointed by the Board of Directors. The Bank originally reserved 76,800 shares (84,672 after stock dividends) of common stock for issuance under this plan. Additional shares were authorized and granted as a result of stock dividends in subsequent years. All options expire ten years from date of grant and vest over a five-year period with 20% in each year. Upon certain change of control events, these options will become fully vested.

F-59

VALLEY BANK

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

INFORMATION RELATING TO MARCH 31, 1999 IS UNAUDITED

NOTE 12. STOCK OPTION PLANS (CONTINUED)

Other pertinent information relating to the plan follows:

<TABLE>

<CAPTION>

	1998		1997		1996	
	NUMBER OF SHARES	WEIGHTED AVERAGE PRICE	NUMBER OF SHARES	WEIGHTED AVERAGE PRICE	NUMBER OF SHARES	WEIGHTED AVERAGE PRICE
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Outstanding, beginning of year.....	75,792	\$ 4.94	79,680	\$ 4.98	70,080	\$ 5.38
Granted.....	--	--	--	--	19,200	3.75
Terminated and canceled.....	(2,712)	5.38	--	--	(9,600)	5.38
5% stock dividend.....	--	--	3,984	4.98	--	--
Options exercised.....	--	--	(7,872)	5.38	--	--
Outstanding, end of year.....	73,080	4.93	75,792	4.94	79,680	\$ 4.98
Exercisable, end of year.....	57,816	5.15	51,072	4.93	35,136	\$ 5.38

As of December 31, 1998

Price of outstanding options..... \$3.75-\$5.37  
Weighted average remaining contractual life of outstanding options..... 6.0 years

</TABLE>

The Bank applies Accounting Principles Board Opinion 25, ACCOUNTING FOR STOCK ISSUED TO EMPLOYEES, and related Interpretations in accounting for its plans. Accordingly, no compensation cost has been recognized. The Bank has elected not to adopt FASB Statement No. 123, ACCOUNTING FOR STOCK-BASED COMPENSATION. Had compensation cost for the Bank's stock option plan been determined based on the fair value at the grant dates for awards under this plan consistent with the method of Statement No. 123, the Bank's net income and net income per common share would have been reduced to the pro forma amounts indicated below:

<TABLE>

<CAPTION>

	1998	1997	1996
<S>	<C>	<C>	<C>
Net income			
As reported.....	\$ 789,000	\$ 556,000	\$ 454,000
Pro forma.....	768,000	532,000	437,000
Basic earnings per share			
As reported.....	0.73	0.53	0.41
Pro forma.....	0.71	0.50	0.40
Diluted earnings per share			

As reported.....	0.65	0.51	0.41
Pro forma.....	0.63	0.48	0.39

The pro forma compensation cost was recognized for the fair value of the stock options granted, which was estimated using the minimum-value method, including a risk-free interest rate of 5.69% and 5.59% for 1997 and 1996, respectively, an estimated life of the options of ten years and no dividend rate or volatility on the stock. The weighted average fair value of

F-60

VALLEY BANK

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

INFORMATION RELATING TO MARCH 31, 1999 IS UNAUDITED

NOTE 12. STOCK OPTION PLANS (CONTINUED)

these stock options granted in 1997 and 1996 was \$2.67 and \$1.58, respectively. There were no stock options granted in 1998.

NOTE 13. FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair value of the Bank's financial instruments is as follows at December 31:

<TABLE>  
<CAPTION>

	1998		1997	
	CARRYING AMOUNT	FAIR VALUE	CARRYING AMOUNT	FAIR VALUE
<S>	<C>	<C>	<C>	<C>
Financial assets:				
Cash and federal funds sold...	\$ 20,265,000	\$ 20,265,000	\$ 10,287,000	\$ 10,287,000
Securities.....	15,585,000	15,642,000	13,856,000	13,920,000
Loans and loans held for sale, net.....	42,031,000	42,843,000	44,202,000	44,902,000
Accrued interest receivable...	611,000	611,000	561,000	561,000
Financial liabilities:				
Deposits.....	75,739,000	75,698,000	66,239,000	66,209,000
Interest payable.....	47,000	47,000	42,000	42,000
ESOP bank note payable.....	478,000	478,000	579,000	579,000

</TABLE>

FAIR VALUE OF COMMITMENTS

The estimated fair value of fee income on letters of credit at December 31, 1998 and 1997 is insignificant. Loan commitments on which the committed interest rate is less than the current market rate are also insignificant at December 31, 1998 and 1997.

NOTE 14. POTENTIAL SALE OF THE BANK

The management of the Bank has entered into a definitive agreement to sell 100% of the common stock of the Bank to a bank holding company in 1999. The potential sale is pending regulatory and shareholder approval. The sale, if completed, is expected to close in June 1999.

NOTE 15. SUBSEQUENT EVENT (UNAUDITED)

On April 30, 1999 the Bank became a defendant in a countersuit, in connection with the Bank's foreclosure proceedings, in which damages of \$1.5 million are claimed. This claim relates to a loan on which the Bank is a 53% participant. Management is vigorously defending itself against this claim and believes that the claim has no merit. It is not possible to determine the outcome of the lawsuit at this time and, therefore, there is no accrual for the claim included in the accompanying financial statements.

F-61

YOU SHOULD RELY ONLY ON THE INFORMATION CONTAINED IN THIS PROSPECTUS. WE HAVE NOT AUTHORIZED ANYONE TO PROVIDE YOU WITH INFORMATION DIFFERENT FROM THAT WHICH IS SET FORTH IN THIS PROSPECTUS. WE ARE OFFERING TO SELL SHARES OF COMMON STOCK AND SEEKING OFFERS TO BUY SHARES OF COMMON STOCK ONLY IN JURISDICTIONS WHERE OFFERS AND SALES ARE PERMITTED. THE INFORMATION CONTAINED IN THIS PROSPECTUS IS ACCURATE ONLY AS OF THE DATE OF THIS PROSPECTUS, REGARDLESS OF THE TIME OF DELIVERY OF THE PROSPECTUS OR OF ANY SALE OF COMMON STOCK.

-----  
 TABLE OF CONTENTS

<u>&lt;TABLE&gt;</u> <CAPTION>	PAGE
<u>&lt;S&gt;</u>	<u>&lt;C&gt;</u>
Prospectus Summary.....	1
Risk Factors.....	6
Use of Proceeds.....	13
Dividend Policy.....	13
Capitalization.....	14
Dilution.....	15
Regulatory Capital and Leverage Ratio.....	16
The Acquisitions.....	16
Unaudited Pro Forma Combined Financial Data.....	17
Pacific Community Banking Group Selected Financial Data.....	22
Management's Discussion and Analysis.....	23
Business.....	24
The Bank of Hemet	
Selected Financial Data.....	27
Management's Discussion and Analysis.....	29
Business.....	46
Valley Bank	
Selected Financial Data.....	63
Management's Discussion and Analysis.....	65
Business.....	81
Management.....	102
Certain Transactions.....	111
Principal and Selling Shareholders.....	111
Supervision and Regulation.....	114
Description of Capital Stock.....	121
Shares Eligible for Future Sale.....	128
Underwriting.....	130
Experts.....	132
Legal Matters.....	132
Additional Information.....	133
Index to Financial Statements.....	F-1

</TABLE>

UNTIL , 1999 (25 DAYS AFTER THE DATE OF THIS PROSPECTUS), ALL DEALERS THAT EFFECT TRANSACTIONS IN THESE SECURITIES, WHETHER OR NOT PARTICIPATING IN THIS OFFERING, MAY BE REQUIRED TO DELIVER A PROSPECTUS. THIS IS IN ADDITION TO THE OBLIGATION OF DEALERS TO DELIVER A PROSPECTUS WHEN ACTING AS UNDERWRITERS AND WITH RESPECT TO THEIR UNSOLD ALLOTMENTS OR SUBSCRIPTIONS.

3,750,000 SHARES

[LOGO]

COMMON STOCK

-----  
 PROSPECTUS  
 -----

SUTRO & CO. INCORPORATED

FRIEDMAN BILLINGS RAMSEY

WEDBUSH MORGAN SECURITIES

RAGEN MACKENZIE INCORPORATED

, 1999

-----  
 PART II

INFORMATION NOT REQUIRED IN PROSPECTUS

ITEM 13. OTHER EXPENSES OF ISSUANCE AND DISTRIBUTION

The following is an itemized list of the estimated expenses to be incurred in connection with this offering of the securities being offered hereunder other

than underwriting discounts and commissions.

<TABLE>  
<CAPTION>

	AMOUNT TO BE PAID -----
<S>	<C>
Registration fee.....	\$ 18,936
NASD filing fee and expenses.....	9,000
Nasdaq National Market listing fee.....	60,000
Printing and Engraving expenses.....	150,000
Legal fees and expenses.....	520,000
Blue Sky qualification fees and expenses.....	3,500
Accounting fees and expenses.....	150,000
Transfer Agent and registrar fees.....	35,000
Miscellaneous.....	3,564
Total.....	\$ 950,000

</TABLE>

ITEM 14. INDEMNIFICATION OF DIRECTORS AND OFFICERS

Article V of the Registrant's Articles of Incorporation, as amended, provides that the liability of the directors of the corporation for monetary damages shall be eliminated to the fullest extent permissible under California law. Article VI of the Registrant's Articles of Incorporation provides that the corporation is authorized to provide for the indemnification of agents (as defined in Section 317 of the California General Corporation Law) of the corporation in excess of that expressly permitted by such Section 317 for breach of duty to the corporation and its shareholders to the fullest extent permissible under California Law.

Article III of the Registrant's Bylaws provides, in pertinent part, that each person who is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another foreign or domestic corporation or other entity, shall be indemnified by the Registrant to the full extent permitted by the General Corporation Law of the State of California or any other applicable laws. Article III also authorizes the registrant to enter into one or more agreements with any person which provides for indemnification greater or different than that provided for in that Article.

The Registrant has entered into indemnification agreements with their respective officers and directors in the forms incorporated by reference as Exhibit 10.1 to this Registration Statement.

Insofar as indemnification for liabilities arising under the Securities Act of 1933, as amended, may be permitted pursuant to the foregoing provisions to directors, officers or persons controlling the Registrant, the Registrant has been informed that, in the opinion of the Securities and Exchange Commission, such indemnification is against public policy as expressed in said Act and is therefore unenforceable.

II-1

Reference is made to the following documents filed as exhibits to this Registration Statement regarding relevant indemnification provisions described above and elsewhere herein:

<TABLE>  
<CAPTION>

DOCUMENT -----	EXHIBIT NUMBER
<S>	<C>
Form of Underwriting Agreement.....	1.1
Articles of Incorporation, as amended.....	3.1
Bylaws.....	3.2
Form of Indemnification Agreements.....	10.1

</TABLE>

ITEM 15. RECENT SALES OF UNREGISTERED SECURITIES

In October 1997, Pacific Community Banking Group sold a total 10,000 shares in order to initially capitalize Pacific Community Banking Group. In the sale, Pacific Community Banking Group relied on the exemption from registration available under Section 4(2) of the Securities Act of 1933, as amended. Mr. E. Lynn Caswell, Chairman, Chief Executive Officer and founder, purchased 10,000 shares for the total consideration of \$2,500.

As of March 31, 1999, Pacific Community Banking Group had 1,085,000 shares of Series A preferred stock outstanding, held at record by 18 shareholders. In

addition, as of March 31, 1999, Pacific Community Banking Group had 375,000 shares of Series B preferred stock outstanding, held at record by 16 shareholders. In the sale of these shares, Pacific Community Banking Group relied on the exemption from registration available under Section 4(2) of the Securities Act of 1933, as amended. Each investor in these securities signed a statement identifying himself or herself as having a family relationship, prior business relationship or financial sophistication and net worth, or more than one of such attributes, that qualifies the investor for the private placement exemption under Section 4(2) of the Securities Act. The Series A preferred stock and the Series B preferred stock are currently the only series of preferred stock with designated terms. Each sale of Series A preferred stock is convertible into shares of Pacific Community Banking Group common stock at a conversion price equal to 80% of the price of Pacific Community Banking Group common stock in this offering of the securities being offered hereunder. Each share of Series B preferred stock is convertible into shares of Pacific Community Banking Group common stock at a conversion price equal to 85% of the price of Pacific Community Banking Group common stock in this offering of the securities being offered hereunder. The holders of Series A and Series B preferred stock do not have voting rights and are not entitled to receive dividends. On the closing of this offering of the securities being offered hereunder, all of the preferred stock will automatically convert to common stock.

ITEM 16. EXHIBITS AND FINANCIAL STATEMENTS

(a) Exhibits

EXHIBIT NUMBER	DESCRIPTION
<C>	<S>
1.1	Form of Underwriting Agreement
2.1*	First Restatement of Agreement and Plan of Reorganization by and between Registrant and The Bank of Hemet dated January 5, 1999.

II-2

EXHIBIT NUMBER	DESCRIPTION
<C>	<S>
2.2*	First Amendment to First Restatement of Agreement and Plan of Reorganization by and between Registrant and The Bank of Hemet dated March 24, 1999.
2.3*	Second Amendment to First Restatement of Agreement and Plan of Reorganization by and between Registrant and The Bank of Hemet dated April 2, 1999.
2.4*	First Restatement of Agreement and Plan of Reorganization by and between Registrant and Valley Bank dated as of January 5, 1999.
2.5*	First Amendment to First Restatement of Agreement and Plan of Reorganization by and between Registrant and Valley Bank dated March 4, 1999.
2.6*	Second Amendment to First Restatement of Agreement and Plan of Reorganization by and between Registrant and Valley Bank dated April 12, 1999.
3.1*	Articles of Incorporation of Registrant.
3.2*	Certificate of Amendment to Articles of Incorporation of Registrant.
3.3*	Amended and Restated Bylaws of Registrant.
3.4*	Certificate of Determination.
4.1*	Specimen Stock Certificate.
4.2*	Forms of Warrant to Shareholders of The Bank of Hemet and Valley Bank.
5.1	Opinion of Morrison & Foerster LLP.
10.1*	Form of Indemnification Agreement.

- 10.2\* Employment Agreement between Registrant and E. Lynn Caswell.
- 10.3 Agreement between Registrant and Harold Williams.
- 10.4 Registrant's 1999 Stock Option Plan.
- 10.5\* Shareholder Agreement.
- 10.6\* Form of Warrant Purchase Agreement.
- 10.7\* Form of Non-competition and Consulting Agreements.
- 10.8\* Form of Continuation Agreement between The Bank of Hemet and certain executives (Jaqua, McDonough) dated March 22, 1995, as amended.
- 10.9\* Head Office Lease, 1600 E. Florida Avenue, Hemet, California.
- 10.10\* Form of Executive Employment Agreement dated September 26, 1996 between Valley Bank and each of Marvin Lentini, Mark Nugent, Bonnie Parrott and Dianna Williams.
- 10.11\* Executive Employment Agreement dated September 26, 1996, as amended October 30, 1997, between Valley Bank and N. Douglas Mills.
- 10.12\* Executive Salary Continuation Agreement, dated October 19, 1995, as amended October 30, 1997, between Valley Bank and N. Douglas Mills.

</TABLE>

II-3

<TABLE>	
<CAPTION>	
EXHIBIT	
NUMBER	DESCRIPTION
-----	
<C>	<S>
10.13*	Second Amendment to Employment Agreement between Valley Bank and N. Douglas Mills.
10.14*	Consulting Agreement between The Bank of Hemet and James B. Jaqua.
10.15*	Noncompetition Agreement between The Bank of Hemet and James B. Jaqua.
10.16*	Amendment No. 3 to Executive Salary Continuation Agreement.
23.1	Consent of Morrison & Foerster LLP (included in their opinion filed as Exhibit 5.1).
23.2	Consent of Arthur Andersen LLP.
23.3	Consent of McGladrey & Pullen, LLP for Valley Bank Financial Statements.
24.1*	Power of Attorney. (Please refer to p. II-4 of Registration Statement on Form S-1 filed April 16, 1999).
27.1*	Financial Data Schedule for the year ended December 31, 1998.
99.1*	Consent of James Jaqua.
99.2*	Consent of N. Douglas Mills.
99.3*	Consent of Marion V. Ashley.
99.4*	Consent of Harold R. Williams, Jr.
99.5*	Consent of John J. McDonough.
99.6*	Consent of Clayton A. Record.
99.7*	Consent of E. Kenneth Hyatt.
99.8*	Consent of Jack E. Gosch.

</TABLE>

\* Previously filed.



(b) Financial Statement Schedules

No schedules are included because the information required to be set forth therein is not applicable or is shown in the financial statements or notes thereto.

II-4

ITEM 17. UNDERTAKINGS

(a) The undersigned registrant hereby undertakes to provide to the underwriter at the closing specified in the underwriting agreements certificates in such denominations and registered in such names as required by the underwriter to permit prompt delivery to each purchaser.

(b) That insofar as indemnification for liabilities arising under the Securities Act may be permitted to directors, officers and controlling persons of the registrant pursuant to the provisions described under Item 14 above, or otherwise, the registrants have been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Securities Act and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the registrant of expenses incurred or paid by a director, officer or controlling person of the registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, the registrant will, unless in the opinion of their counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Securities Act and will be governed by the final adjudication of such issue.

The undersigned registrant hereby undertakes:

(c) That, for purposes of determining any liability under the Securities Act, the information omitted from the form of prospectus filed as part of this Registration Statement in reliance upon Rule 430A and contained in a form of prospectus filed by the registrants pursuant to Rule 424(b)(1) or (4) or 497(h) under the Securities Act shall be deemed to be part of this Registration Statement as of the time it was declared effective.

(d) That, for the purpose of determining any liability under the Securities Act, each post-effective amendment that contains a form of prospectus shall be deemed to be a new registration statement relating to the securities offered therein, and this offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

II-5

SIGNATURES

Pursuant to the requirements of the Securities Act of 1933, as amended, the Registrant has duly caused this Amendment No. 4 to the Registration Statement on Form S-1 to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Laguna Hills, County of Orange, State of California, on July 27, 1999.

<TABLE>

<S> <C> <C>  
PACIFIC COMMUNITY BANKING GROUP  
By: /s/ E. LYNN CASWELL  
-----  
Chairman of the Board, Chief Executive  
Officer and Chief Financial Officer

</TABLE>

Pursuant to the requirements of the Securities Act of 1933, this Amendment No. 4 to the Registration Statement on Form S-1 has been signed by the following persons in the capacities indicated, on July 27, 1999.

<TABLE>

<CAPTION>  
SIGNATURE TITLE  
<C> <S>  
E. Lynn Caswell, Chairman  
/s/ E. LYNN CASWELL of the Board of  
----- Directors, Chief

E. Lynn Caswell Executive Officer and  
Chief Financial Officer

/s/ MITCHELL ALLEN\*

Mitchell Allen, Director

Mitchell Allen

/s/ ALFRED JANNARD\*

Alfred Jannard, Director

Alfred Jannard

/s/ CARLOS SAENZ\*

Carlos Saenz, Director

Carlos Saenz

/s/ HENRY SCHIELEIN\*

Henry Schielein, Director

Henry Schielein

</TABLE>

<TABLE>

<S> <C>

<C>

\*By: /s/ E. LYNN CASWELL

E. Lynn Caswell  
ATTORNEY-IN-FACT

</TABLE>

II-6

EXHIBIT INDEX

<TABLE>

<CAPTION>

EXHIBIT

NUMBER DESCRIPTION

<C> <S>

1.1 Form of Underwriting Agreement

2.1\* First Restatement of Agreement and Plan of Reorganization by and between Registrant and The Bank of Hemet dated January 5, 1999.

2.2\* First Amendment to First Restatement of Agreement and Plan of Reorganization by and between Registrant and The Bank of Hemet dated March 24, 1999.

2.3\* Second Amendment to First Restatement of Agreement and Plan of Reorganization by and between Registrant and The Bank of Hemet dated April 2, 1999.

2.4\* First Restatement of Agreement and Plan of Reorganization by and between Registrant and Valley Bank dated as of January 5, 1999.

2.5\* First Amendment to First Restatement of Agreement and Plan of Reorganization by and between Registrant and Valley Bank dated March 4, 1999.

2.6\* Second Amendment to First Restatement of Agreement and Plan of Reorganization by and between Registrant and Valley Bank dated April 12, 1999.

3.1\* Articles of Incorporation of Registrant.

3.2\* Certificate of Amendment of Articles of Incorporation of Registrant.

3.3\* Amended and Restated Bylaws of Registrant.

3.4\* Certificate of Determination.

4.1\* Specimen Stock Certificate.

4.2\* Forms of Warrant to Shareholders of The Bank of Hemet and Valley Bank.

5.1 Opinion of Morrison & Foerster LLP.

10.1\* Form of Indemnification Agreement.

10.2\* Employment Agreement between Registrant and E. Lynn Caswell.

10.3 Agreement between Registrant and Harold Williams.

10.4 Registrant's 1999 Stock Option Plan.

- 10.5\* Shareholder Agreement.
- 10.6\* Form of Warrant Purchase Agreement.
- 10.7\* Form of Non-competition and Consulting Agreements.
- 10.8\* Form of Continuation Agreement between The Bank of Hemet and certain executives (Jaqua, McDonough) dated March 22, 1995, as amended.
- 10.9\* Head Office Lease, 1600 E. Florida Avenue, Hemet, California.
- 10.10\* Form of Executive Employment Agreement dated September 26, 1996 between Valley Bank and each of Marvin Lentini, Mark Nugent, Bonnie Parrott and Dianna Williams.
- 10.11\* Executive Employment Agreement dated September 26, 1996, as amended October 30, 1997, between Valley Bank and N. Douglas Mills.

</TABLE>

<TABLE>

<CAPTION>

EXHIBIT

NUMBER DESCRIPTION

<C>	<S>
10.12*	Executive Salary Continuation Agreement, dated October 19, 1995, as amended October 30, 1997, between Valley Bank and N. Douglas Mills.
10.13*	Second Amendment to Employment Agreement between Valley Bank and N. Douglas Mills.
10.14*	Consulting Agreement between The Bank of Hemet and James B. Jaqua.
10.15*	Noncompetition Agreement between The Bank of Hemet and James B. Jaqua.
10.16*	Amendment No. 3 to Executive Salary Continuation Agreement.
23.1	Consent of Morrison & Foerster LLP (included in their opinion filed as Exhibit 5.1).
23.2	Consent of Arthur Andersen LLP.
23.3	Consent of McGladrey & Pullen, LLP for Valley Bank Financial Statements.
24.1*	Power of Attorney. (Please refer to p. II-4 of Registration Statement on Form S-1 filed April 16, 1999).
27.1*	Financial Data Schedule for the year ended December 31, 1998.
99.1*	Consent of James Jaqua.
99.2*	Consent of N. Douglas Mills.
99.3*	Consent of Marion V. Ashley.
99.4*	Consent of Harold R. Williams, Jr.
99.5*	Consent of John J. McDonough.
99.6*	Consent of Clayton A. Record.
99.7*	Consent of E. Kenneth Hyatt.
99.8*	Consent of Jack E. Gosch.

</TABLE>

-----

\* Previously filed.

[FORM OF UNDERWRITING AGREEMENT]

UNDERWRITING AGREEMENT  
(the "Agreement")

\_\_\_\_\_ Shares  
(Subject to increase of up to \_\_\_\_\_ (15%) additional  
shares in the event of an oversubscription)

PACIFIC COMMUNITY BANKING GROUP  
(A CALIFORNIA CORPORATION)

Common Stock  
(no par value per share)

UNDERWRITING AGREEMENT

July 27, 1999

Sutro & Co. Incorporated  
Friedman, Billings, Ramsey & Co., Inc.  
Wedbush Morgan Securities, Inc.  
Ragen MacKenzie Incorporated  
As Representatives of the several Underwriters  
c/o Sutro & Co. Incorporated  
11150 Santa Monica Boulevard, Suite 1500  
Los Angeles, California 90025

Ladies and Gentlemen:

Pacific Community Banking Group, a California corporation (the "Company") proposes, subject to the terms and conditions stated herein, to issue and sell to the several Underwriters named in Schedule A hereto (the "Underwriters"), for which you are acting as representatives (the "Representatives"), an aggregate of up to \_\_\_\_\_ shares of common stock, no par value per share (the "Common Stock"), of the Company. The shareholders listed in Schedule B hereto as either "Hemet Major Selling Shareholders," "Valley Major Selling Shareholders" or "Other Selling Shareholders" (together, the "Selling Shareholders") agree severally but not jointly to sell to the Underwriters an aggregate of up to \_\_\_\_\_ outstanding shares of Common Stock. The "Hemet Major Selling Shareholders" and "Valley Major Selling

Shareholders," together, are sometimes referred to herein as the "Major Selling Shareholders." The \_\_\_\_\_ shares of Common Stock to be sold by the Company and the \_\_\_\_\_ shares of Common Stock to be sold by the Selling Shareholders are collectively referred to herein as the "Shares" or the "Firm Common Shares." In addition, the Company grants to the Underwriters an option to purchase up to 525,000 additional shares of Common Stock ((15% OF OFFERING FIRM COMMON SHARES) the "Optional Common Shares"), as provided in Section 4(c) hereof, for the purpose of covering over-allotments in connection with the sale of the Firm Common Shares. The Firm Common Shares and, to the extent such option is exercised, the Optional Common Shares are hereinafter collectively referred to as the "Common Shares."

The Company and the Selling Shareholders understand that the Underwriters propose to make a public offering of the Common Shares on the effective date of the registration statement hereinafter referred to or as soon thereafter as in your judgment is advisable. The Company and the Selling Shareholders hereby confirm that the Underwriters and any dealers have been authorized to distribute or cause to be distributed each Preliminary Prospectus (as defined below) and are authorized to distribute the Prospectus (as defined below), as from time to time amended or supplemented, on the effective date of the registration statement hereinafter referred to or as soon thereafter as in your judgment is advisable.

The Company and the Selling Shareholders confirm their agreement with respect to the purchase of the Common Shares by the Underwriters as follows:

#### SECTION 1. Representations and Warranties.

(A) The Company hereby represents and warrants to, and agrees with, each of the Underwriters that:

(a) A registration statement on Form S-1 (File No. 333-76403) (the "Registration Statement") with respect to the Common Shares has been prepared by the Company in conformity in all material respects with the requirements of the Securities Act of 1933, as amended (the "Act"), and the rules and regulations (the "Rules and Regulations") of the Securities and Exchange Commission (the "Commission") thereunder, and has been filed with the Commission. The Registration Statement contains information regarding The Bank of Hemet ("Hemet") and Valley Bank ("Valley") and the Hemet subsidiaries (Hemet and Valley are collectively referred to herein as the "Banks"), each of which the Company proposes to acquire after the Registration Statement becomes effective. The Company has prepared and has filed or proposes to file prior to the effective date of such Registration Statement an amendment or amendments to such Registration Statement, which amendment or amendments have been or will be similarly prepared. There have been delivered to you

two signed copies of such Registration Statement and amendments, together with two copies of each exhibit filed therewith. Conformed copies of such registration statement and amendments thereto and related preliminary prospectuses have been delivered to you in such reasonable quantities as you have requested. The Company will next file with the Commission one of the following: (i) prior to effectiveness of such registration statement, a further amendment thereto, including the form of Final Prospectus, (ii) a Final Prospectus in accordance with Rules 430A and 424(b) of the Rules and Regulations or (iii) a term sheet (the "Term Sheet") as described in and in accordance with Rules 434 and 424(b) of the Rules and Regulations. As filed, the Final Prospectus, if one is used, or the Term Sheet and the latest Preliminary Prospectus sent or given to purchasers of the Common Shares by the Underwriters prior to or at the same time as the confirmation of such sale, if a final prospectus is not used, shall include all Rule 430A Information (as defined below) and, except to the extent that you shall agree in writing to a modification, shall be in all substantive respects in the form furnished to you prior to the date and time that this Agreement was executed and delivered by the parties hereto, or, to the extent not completed at such date and time, shall contain only such specific additional information and other changes (beyond that contained in the latest Preliminary Prospectus) as the Company shall have previously advised you in writing would be included or made therein.

The term "Registration Statement" as used herein shall mean such registration statement at the time such registration statement becomes effective and, in the event any post-effective amendment thereto becomes effective prior to the First Closing Date (as defined below), also shall mean such registration statement as so amended; provided, however, that such term shall also include (i) all Rule 430A Information deemed to be included in such registration statement at the time such registration statement becomes effective as provided by Rule 430A of the Rules and Regulations and (ii) any registration statement filed pursuant to Rule 462(b) of the Rules and Regulations relating to the Common Shares. The term "Preliminary Prospectus" shall mean any preliminary prospectus relating to the Common Shares and delivered to you as well as any preliminary prospectus included in the Registration Statement at the time it becomes effective that omits Rule 430A Information. The term "Prospectus" shall mean: (i) the prospectus relating to the Common Shares in the form in which it is first filed with the Commission pursuant to Rule 424(b) of the Rules and Regulations; (ii) if a Term Sheet is not used and no filing pursuant to Rule 424(b) of the Rules and Regulations is required, the form of final prospectus included in the Registration Statement at the time it becomes effective; or (iii) if a Term Sheet is used, the Term Sheet in the form in which it is first filed with the Commission pursuant to Rule 424(b) of the Rules and Regulations, together with the latest Preliminary Prospectus sent or given to purchasers of the Common Shares by the Underwriters prior to or at the same time as the confirmation of such sale. The term "Rule 430A Information" shall mean information with respect to the Common Shares and the offering thereof permitted to be omitted from the Registration Statement when it becomes effective

pursuant to Rule 430A of the Rules and Regulations.

The Company has filed a Registration Statement on Form S-4 (File No.: 333-76401) with respect to the Company's offer to exchange its securities for securities of the Banks prior to the sale of the Firm Common Shares. As used herein, the "Bank S-4" shall mean such registration statement at the time such registration statement becomes effective and, in the event any post-effective amendment thereto becomes effective prior to the First Closing Date (as defined below), also shall mean such registration statement as so amended; provided, however, that such term shall also include (i) all Rule 430A information deemed to be included in such registration statement at the time such registration statement becomes effective as provided by Rule 430A of the Rules and Regulations and (ii) any registration statement filed pursuant to Rule 462(b) of the Rules and Regulations relating to the Common Shares. The term "S-4 Prospectus" shall mean: (i) as the context dictates, the proxy statement/prospectus relating to the Company's offer to exchange its securities for those of the Hemet and/or Valley, as the case may be, in the form in which it is first filed with the Commission pursuant to Rule 424(b) of the Rules and Regulations; or (ii) if no filing pursuant to Rule 424(b) of the Rules and Regulations is required, the form of final joint proxy statement/prospectus included in the Bank S-4 at the time it becomes effective.

A Registration Statement on Form 8-A (the "Form 8-A") with respect to the common stock of the Company has been prepared in conformity with the requirements of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and the Exchange Act and the rules and regulations of the Securities and Exchange Commission thereunder. Such Form 8-A has been filed with the Commission or will be filed not later than the time when the Registration Statement becomes effective.

(b) The Commission has not issued any order preventing or suspending the use of any Preliminary Prospectus, and each Preliminary Prospectus has conformed in all material respects to the requirements of the Act and the Rules and Regulations and, as of its date, has not included any untrue statement of a material fact or omitted to state a material fact necessary to make the statements therein, in the light of the circumstances under which they were made, not misleading; at the time the Registration Statement becomes effective, and at all times subsequent thereto up to and including each Closing Date hereinafter mentioned, the Registration Statement and the Prospectus, and any amendments or supplements thereto, will contain all material statements and information required to be included therein by the Act and the Rules and Regulations and will in all material respects conform to the requirements of the Act and the Rules and Regulations, and the Registration Statement will not include any untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary, in light of the circumstances under which they were made, to make

the statements therein not misleading, and neither the Prospectus, nor any

amendment or supplement thereto, will include any untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary, in light of the circumstances under which they were made, to make the statements therein not misleading; provided, however, no representation or warranty contained in this subsection 1(A)(b) shall be applicable to information contained in or omitted from any Preliminary Prospectus, the Registration Statement, the Prospectus or any such amendment or supplement that is described in clauses (i) and (ii) of Section 3 hereof.

(c) The Company has two subsidiaries, Interim Valley Bank and PCBG Merger Corporation (the "Company Subsidiaries"). With the exception of the Company Subsidiaries, the Company does not own or control, directly or indirectly, any corporation, association or other entity. Valley Bank has no subsidiaries, and does not own or control, directly or indirectly, any corporation, association or other entity. Hemet has five wholly owned subsidiaries, Banklink Corporation, Hemet Service Corporation, Florida Avenue Investment Company, Inland Diversified, Inc. and B.O.H. Escrow Company (collectively, the "Hemet Subsidiaries"). With the exception of the Hemet Subsidiaries, Hemet does not own or control, directly or indirectly, any corporation, association or other entity. The Company, the Company Subsidiaries, each of the Banks and [Banklink Corporation] have been duly incorporated and are validly existing as corporations in good standing under the laws of California with full power and authority (corporate and other) to own and lease their respective assets and properties and to conduct their respective businesses as now being conducted and as described in the Registration Statement. The Company, the Company Subsidiaries, each of the Banks and [Banklink Corporation] are duly qualified to do business and are in good standing as foreign corporations in each jurisdiction in which the ownership or leasing of their respective properties or the conduct of their respective businesses requires such qualification, except for jurisdictions in which the failure to so qualify would not have a material adverse effect upon the Company or either of the Banks taken as a whole and to the Company's knowledge, no proceeding has been instituted in any such jurisdiction revoking, limiting or curtailing, or seeking to revoke, limit or curtail, such power and authority or qualification.

(d) The Company, the Company Subsidiaries, each of the Banks and [Banklink Corporation] holds and is operating in compliance with all licenses, approvals, certificates, permits, authorizations, consents and orders from governmental and regulatory authorities, foreign and domestic, which are necessary or required in the conduct of its business. The Hemet Subsidiaries other than Banklink Corporation are inactive and conduct no business.

(e) The Company has the authorized capitalization as set forth under the heading "Capitalization" in the Prospectus. The issued and



outstanding shares of capital stock and all securities of the Company, are duly authorized and validly issued,

are fully paid and nonassessable, have been issued in compliance with all applicable federal and state securities laws, have not been issued in violation of or subject to any preemptive rights or other rights to subscribe for or purchase securities, and conform in all material respects to the description thereof contained in the Prospectus. To the knowledge of the Company, after reasonable investigation, the issued and outstanding shares of capital stock and all securities of each of the Banks and the Hemet subsidiaries, are duly authorized, validly issued, fully paid and nonassessable, have been issued in compliance with all applicable federal and state securities laws, except for shares issued to Ken Ray, have not been issued in violation of or, except for certain rights of Valley, subject to any preemptive rights or other rights to subscribe for or purchase securities, and confirm in all material respects to the description thereof contained in the S-4 Prospectus. Except as disclosed in or contemplated by the Prospectus and the financial statements of the Company, and the related notes thereto, included in the Prospectus, the Company has no outstanding options to purchase, or any preemptive rights or other rights to subscribe for or to purchase, any securities or obligations convertible into, or any contracts or commitments to issue or sell, shares of capital stock of the Company or any such options, rights, convertible securities or obligations. To the knowledge of the Company, after reasonable investigation, except as disclosed in or contemplated by the S-4 Prospectus and the financial statements of the Banks, and the related notes thereto, included in the S-4 Prospectus, neither of the Banks has outstanding options to purchase, or any preemptive rights or other rights to subscribe for or to purchase, any securities or obligations convertible into, or any contracts or commitments to issue or sell, shares of capital stock of the Banks or any such options, rights, convertible securities or obligations. The description of the Company's stock option, stock bonus and other stock plans or arrangements, and the options or other rights granted or intended to be granted thereunder, set forth in the Prospectus accurately and fairly presents the information required to be shown with respect to such plans, arrangements, options and rights.

(f) The Common Shares have been duly authorized and, when issued, delivered and paid for in the manner set forth in this Agreement, will be validly issued, fully paid and nonassessable, and will conform to the description thereof contained in the Prospectus. No preemptive rights or other rights to subscribe for or purchase exist with respect to the issuance and sale of the Common Shares, except for options described in (e) above, such rights as may be held by holders of the Company's Preferred Stock issued and outstanding as of the date of this Agreement, and the Company's Warrants to be issued as described in the S-4 Prospectus. No shareholder of the Company has any right which has not been waived to require the Company to register the sale of any shares owned by such shareholder under the Act in

the public offering contemplated by this Agreement. No further approval or authorization of the shareholders or the Board of Directors of the Company is required for the issuance and sale of the Common Shares as contemplated herein.

(g) The Company has full right, power and authority to enter into this Agreement and perform the transactions contemplated in this Agreement. This Agreement has and, prior to the First Closing Date (as defined below) will have been, duly authorized, executed and delivered by the Company, and constitutes the valid and binding agreement of the Company enforceable against it in accordance with its terms, except (A) as limited by bankruptcy, insolvency, reorganization, moratorium or similar laws affecting creditors' rights generally, (B) that the remedy of specific performance and injunctive and other forms of equitable relief may be subject to equitable defenses and to the discretion of the court before which any proceeding may be brought and (C) to the extent that rights to indemnity or contribution under this Agreement or may be limited by federal or state securities laws or the public policy underlying such laws. The execution and delivery of this Agreement by the Company and the consummation of the transactions contemplated thereby by the Company do not violate any provisions of the articles of incorporation or bylaws of the Company and will not conflict with, result in the breach or violation of, or constitute, either by themselves or upon notice or the passage of time or both, a default under any agreement, mortgage, deed of trust, lease, franchise, license, indenture, permit or other instrument to which the Company or any of the Banks is a party or by which the Company or either of the Banks or any of their respective properties may be bound or affected, any statute or any authorization, judgment, decree, order, rule or regulation of any court or any regulatory body, administrative agency or other governmental body applicable to the Company or any of their respective properties. No consent, approval, authorization or other order of any court, regulatory body, administrative agency or other governmental body is required for the execution and delivery of this Agreement or the consummation of the transactions contemplated by such agreements, except for compliance with the Act, the Blue Sky laws applicable to the public offering of the Common Shares by the several Underwriters and the clearance of such offering with the National Association of Securities Dealers, Inc. (the "NASD").

(h) The Company and Hemet each has full right, power and authority to enter into the First Restated Agreement and Plan of Reorganization with the Bank of Hemet, dated January 5, 1999, and the exhibits thereto, as amended on March 4, 1999 and on April 2, 1999 (the "Hemet Reorganization Agreement"), and the Company and Valley Bank each has full right, power and authority to enter into the First Restated Agreement and Plan of Reorganization with Valley Bank, dated January 5, 1999, and the exhibits thereto, as amended on March 24, 1999 and on April 12, 1999 (the "Valley Reorganization Agreement," and collectively with the Hemet Reorganization Agreement, the "Reorganization Agreements"), and perform the

transactions contemplated in such agreements. The Reorganization Agreements have each been duly authorized, executed and delivered by the Company and the Banks, and they constitute the valid and binding agreements of the Company and the Banks enforceable against each of them in accordance with their respective terms, except (A) as limited by

bankruptcy, insolvency, reorganization, moratorium or similar laws affecting creditors' rights generally, (B) that the remedy of specific performance and injunctive and other forms of equitable relief may be subject to equitable defenses and to the discretion of the court before which any proceeding may be brought. The execution and delivery of the Reorganization Agreements and the consummation of the transactions contemplated in such agreements by the Company and the Company Subsidiaries, as appropriate, does not violate any provisions of the articles of incorporation or bylaws of the Company or the Company subsidiaries or the Banks, as appropriate, and will not conflict with, result in the breach or violation of, or constitute, either by itself or upon notice or the passage of time or both, a default under any agreement, mortgage, deed of trust, lease, franchise, license, indenture, permit or other instrument to which the Company, the Company Subsidiaries or either of the Banks is party or by which the Company, the Company Subsidiaries or either of the Banks or any of their respective properties may be bound or affected, any statute or any authorization, judgment, decree, order, rule or regulation of any court or any regulatory body, administrative agency or other governmental body applicable to the Company, the Company Subsidiaries or the Banks or any of their respective properties. No consent, approval, authorization or other order of any court, regulatory body, administrative agency or other governmental body is required for the execution and delivery of the Reorganization Agreements except for compliance with the Federal Deposit Insurance Act, the Federal Reserve Act and the California Financial Code.

(i) The Company, the Company Subsidiaries and the Banks have obtained all necessary governmental approvals to consummate the Company's acquisition of each of the Banks in accordance with the terms of the Reorganization Agreements, and to the best of the Company's knowledge, no action is pending or threatened to prevent the consummation the transactions contemplated by the Reorganization Agreements;

(j) Arthur Andersen, LLP and McGladrey & Pullen, LLP, who have expressed their opinions with respect to the financial statements filed with the Commission as a part of the Registration Statement and included in the Prospectus, are independent accountants as required by the Act and the Rules and Regulations.

(k) The historical financial statements of the Company and, to the knowledge of the Company after reasonable investigation, the Banks included in the Registration Statement and the Prospectus present fairly the financial position of the Company and the Banks, as of the respective dates

of such financial statements and schedules, and the results of operations, cash flows and shareholders' equity and the other information purported to be shown therein of the Company and the Banks for the respective periods covered thereby. Such statements and related notes of the Company, and, to the knowledge of the Company after reasonable investigation, have

been prepared in accordance with generally accepted accounting principles applied on a consistent basis (except as noted therein) as certified by the independent accountants named in subsection 1(A)(j). The Registration Statement includes all of the financial statements and schedules required under the Act to be included therein. The pro forma financial statements, together with related schedules and notes, set forth in the Prospectus and the Registration Statement, comply as to form in all material respects with the requirements of the Act. Such pro forma financial statements have been prepared on the basis consistent with such historical statements, except for the pro forma adjustments specified therein, and give effect to assumptions made on a reasonable basis and present fairly the historical and proposed transactions contemplated by the Prospectus and this Agreement. The selected financial data set forth in the Prospectus under the captions "Unaudited Pro Forma Combined Financial Information," "Pacific Community Banking Group Selected Financial Data" "The Bank of Hemet Selected Financial Data" and "Valley Bank Selected Financial Data" present fairly the information set forth therein on the basis stated in the Registration Statement.

(l) Except as disclosed in the Prospectus, and except as to defaults which individually or in the aggregate would not have a material adverse effect on the Company or either of the Banks, (i) none of the Company, the Company Subsidiaries or any of the Banks or any of the Hemet Subsidiaries is in violation or default of any provision of their respective articles of incorporation or bylaws, or is in breach of or default with respect to any provision of any agreement, judgment, decree, order, mortgage, deed of trust, lease, franchise, license, indenture, permit or other instrument to which it is a party or by which it or any of its properties is bound; and (ii) there does not exist any state of facts which constitutes an event of default (as defined in such documents) on the part of the Company, the Company Subsidiaries or any of the Banks or any of the Hemet Subsidiaries which, with notice or lapse of time or both, would constitute such an event of default.

(m) There are no contracts or other documents required to be described in the Registration Statement or to be filed as exhibits to the Registration Statement by the Act or by the Rules and Regulations which have not been described or filed as required. The contracts so described in the Prospectus are in full force and effect on the date hereof and have been duly authorized and validly entered into by the Company, the Company Subsidiaries, the Banks or the Hemet Subsidiaries, as appropriate; and, except as disclosed in the Prospectus and except as to defaults which individually or in the aggregate would not be material to the Company and the Banks, taken as a

whole, neither the Company, the Company Subsidiaries, nor any of the Banks or the Hemet Subsidiaries, nor to the best of the Company's knowledge, any other party, is in breach of or in default under any of such contracts.

(n) There are no legal or governmental actions, suits or proceedings

pending or, to the Company's knowledge after reasonable investigation, threatened to which the Company, the Company Subsidiaries, the Banks or the Hemet Subsidiaries is a party or of which property owned or leased by any of them is the subject, including actions related to environmental or discrimination matters, which actions, suits or proceedings (i) might reasonably be expected to, individually or in the aggregate, prevent or materially and adversely affect the transactions contemplated by this Agreement or result in a material adverse change in the condition (financial or otherwise), properties, business, results of operations or prospects of the Company, taken as a whole, or (ii) questions the validity of any of the securities of the Company, this Agreement, or of any action taken or to be taken by the Company pursuant to or in connection with this Agreement; and no labor disturbance by the employees of the Company or any of the Banks or any of the Hemet Subsidiaries exists or is imminent which might reasonably be expected to have a material adverse effect on the Company or either of the Banks. Neither the Company, either of the Banks or the Hemet Subsidiaries is not a party or subject to the provisions of any material injunction, judgment, decree or order of any court, regulatory body, administrative agency or other governmental body.

(o) The Company, the Company Subsidiaries, each of the Banks and each of the Hemet Subsidiaries has good and valid title to all the properties and assets reflected as owned in the financial statements hereinabove described or as described elsewhere in the Prospectus, subject to no lien, mortgage, pledge, charge or encumbrance of any kind except (i) those, if any, reflected in such financial statements or as described elsewhere in the Prospectus and (ii) those which are not material in amount and do not materially and adversely affect the use made and proposed to be made of such property and assets by the Company, either of the Banks or the Hemet Subsidiaries. The Company, the Company Subsidiaries, each of the Banks and each of the Hemet Subsidiaries hold their respective leased properties under valid and binding leases, with such exceptions as are not materially significant in relation to the business of the Company, the Banks and the Hemet Subsidiaries. Except as disclosed in the Prospectus, each of the Company, the Company Subsidiaries, each of the Banks and each of the Hemet Subsidiaries owns or leases all such properties as are necessary to their respective operations as now conducted.

(p) Since the respective dates as of which information is given in the Registration Statement and the Prospectus, and except as described in

or specifically contemplated by the Prospectus: (i) neither the Company or the Company Subsidiaries, nor any of the Banks nor any of the Hemet Subsidiaries has incurred any material liabilities or obligations, indirect, direct or contingent, or entered into any material verbal or written agreement or other transaction which is not in the ordinary course of business or which could reasonably be expected to result in a material reduction in the future earnings of the Company or either of the Banks; (ii) the Company and each of the Banks and the Hemet Subsidiaries have not sustained any material loss or interference

with their respective businesses or properties from fire, flood, earthquake, windstorm, accident or other calamity, whether or not covered by insurance; (iii) the Company has not paid or declared any dividends or other distributions with respect to its capital stock and the Company and each of the Banks and each of the Hemet Subsidiaries are not in default in the payment of principal or interest on any outstanding debt obligations; (iv) there has not been any change in the capital stock (other than upon the sale of the Common Shares hereunder and the exchange of preferred shares for common shares) or indebtedness of the Company or any of the Banks or any of the Hemet Subsidiaries that is material to the Company or the Banks, taken individually (other than in the ordinary course of business); and (v) there has not been any material change in the condition (financial or otherwise), business, properties, results of operations or prospects of the Company, the Banks or the Hemet Subsidiaries.

(q) The Company and, to the knowledge of the Company, after reasonable investigation, each of the Banks and each of the Hemet Subsidiaries have sufficient trademarks, trade names, service marks, patent rights, copyrights, licenses, know-how and other similar rights and proprietary knowledge (collectively, "Intangibles") to conduct their respective businesses as now conducted, and the Company has no knowledge of any material infringement by any of the Company or the Banks or the Hemet Subsidiaries of any Intangible of others, and there is no claim being made against the Company or the Banks or the Hemet Subsidiaries regarding any Intangible which could have a material adverse effect on the Company or either of the Banks.

(r) The Company has not been advised, and has no reason to believe, that any of the Company or either of the Banks or any of the Hemet Subsidiaries is not conducting its business in compliance with all applicable laws, rules and regulations of the jurisdictions in which it is conducting business, including, without limitation, all applicable local, state and federal environmental laws and regulations, except where failure to be in compliance therewith would not have a material adverse effect on the Company or either of the Banks.

Notwithstanding the foregoing, to the Company's knowledge, the Company, the Banks and each of the Hemet Subsidiaries are in compliance with all

Environmental Regulations; (ii) except as disclosed in Schedule 1(r) hereto, there are no Tanks on or above Company and Bank Property; (iii) there are no Hazardous Materials on, below or above the surface of, or migrating from Company and Bank Property that would reasonably have a material adverse effect on the Company or the Banks; (iv) the Company, the Banks and each of the Hemet subsidiaries have no loans outstanding secured by real property that is not in compliance with Environmental Regulations or which has a Tank that is not in compliance with Environmental Regulations or upon which there are Hazardous Materials on or migrating from; and (v) without limiting the foregoing representations and warranties contained in clauses (i)

through (iv), as of the date of this Agreement, there is no claim, action, suit, or proceeding or notice thereof before any governmental entity pending against Company, the Banks or any of the Hemet Subsidiaries or concerning property securing Company, the Banks or Hemet Subsidiaries loans and there is no outstanding judgment, order, writ, injunction, decree, or award against or affecting Company and Bank Property or property securing Company or Bank loans, relating to the foregoing representations (i) - (iv). For purposes of this section, the term "Environmental Regulations" shall mean all applicable statutes, regulations, rules, ordinances, codes, licenses, permits, orders, approvals, plans, authorizations, concessions, franchises, and similar items, of all governmental entities and all applicable judicial, administrative, and regulatory decrees, judgments, and orders relating to the protection of human health or the environment, including, without limitation: all requirements, including, but not limited to those pertaining to reporting, licensing, permitting, investigation, and remediation of emissions, discharges, releases, or threatened releases of Hazardous Materials, chemical substances, pollutants, contaminants, or hazardous or toxic substances, materials or wastes whether solid, liquid, or gaseous in nature, into the air, surface water, groundwater, or land, or relating to the manufacture, processing, distribution, use, treatment, storage, disposal, transport, or handling of chemical substances, pollutants, contaminants, or hazardous or toxic substances, materials, or wastes, whether solid, liquid, or gaseous in nature and all requirements pertaining to the protection of the health and safety of employees or the public. "Company and Bank Property" shall mean real estate owned, leased, or otherwise operated by Company, the Banks or the Hemet Subsidiaries or in which the Company, the Banks or the Hemet subsidiaries has an investment (by sale and lease-back or otherwise) in each case, which real estate is owned, leased, or otherwise used on the date of this Agreement, including, without limitation, properties under foreclosure and properties held by the Company, the Banks or the Hemet subsidiaries in its capacity as a trustee. "Tank" shall mean treatment or storage tanks, sumps, gas or oil wells and associated piping transportation devices. "Hazardous Materials" shall mean any substance the presence of which requires investigation or remediation under any federal, state or local statute, regulation, ordinance, order action, policy or common law; or which is or becomes defined as a hazardous waste, hazardous substance, hazardous material, used oil, pollutant or contaminant under any federal, state or local statute, regulation, rule or ordinance or amendments thereto including, without limitation, the

Comprehensive Environmental Response, Compensation and Liability Act (42 U.S.C. Section 9601, ET SEQ.); the Resource Conservation and Recovery Act (42 U.S.C. Section 6901, ET SEQ.); the Clean Air Act, as amended (42 U.S.C. Section 7401, ET SEQ.); the Federal Water Pollution Control Act, as amended (33 U.S.C. Section 1251, ET SEQ.); the Toxic Substances Control Act, as amended (15 U.S.C. Section 9601, ET SEQ.); the Occupational Safety and Health Act, as amended (29 U.S.C. Section 651 ET SEQ.); the Emergency Planning and Community Right-to-Know Act of 1986 (42 U.S.C. Section 11001, ET SEQ.); the Mine Safety and Health Act of 1977, as amended (30 U.S.C. Section 801, ET SEQ.); the Safe Drinking Water Act (42 U.S.C. Section 300f, ET SEQ.);

and all comparable state and local laws, including without limitation, the Carpenter-Presley-Tanner Hazardous Substance Account Act (State Superfund), the Porter-Cologne Water Quality Control Act, Section 25140, 25501(j) and (k), 25501.1, 25281 and 25250.1 of the California Health and Safety Code and/or Article I of Title 22 of the California Code of Regulations, Division 4, Chapter 30; laws of other jurisdictions or orders and regulations; or the presence of which causes or threatens to cause a nuisance, trespass or other common law tort upon real property or adjacent properties or poses or threatens to pose a hazard to the health or safety of persons, which contains gasoline, diesel fuel or other petroleum hydrocarbons; polychlorinated biphenyls (PCBs), asbestos or urea formaldehyde foam insulation.

(s) The Company and, to the knowledge of the Company after reasonable investigation, each of the Banks have filed, or applied in good faith for extensions of, all necessary federal, state and foreign tax returns and have paid all taxes shown as due thereon; and the Company has no knowledge of any tax deficiency which has been or might be asserted or threatened against the Company or the Banks which could have a material adverse effect on the Company or either of the Banks.

(t) To the best of the Company's knowledge, the Company, each of the Banks and each of the Hemet Subsidiaries have not violated any provisions of any federal, state or local law relating to discrimination in the hiring, promotion or pay of employees nor any applicable wage or hour laws, nor any provisions of the Employee Retirement Income Security Act of 1974 or the rules and regulations promulgated thereunder. There is no significant pending labor practice complaint pending against the Company or the Banks. To the best of the Company's knowledge, there is no union representation question existing with respect to the employees of the Company or the Banks or the Hemet subsidiaries. To the best of the Company's knowledge, there are no pending or threatened union organizing activities with respect to the Company, the Banks or the Hemet Subsidiaries.

(u) Neither the Company nor any of the Banks is, nor upon completion of the sale of Common Shares contemplated hereby will be, an "investment company" within the meaning of the Investment Company Act of 1940, as amended.



(v) The Company has not distributed and will not distribute prior to the First Closing Date any offering materials in connection with the offering and sale of the Common Shares other than any Preliminary Prospectus, the Prospectus, the Registration Statement, the Bank S-4, the S-4 Prospectus and the other materials permitted by the Act.

(w) The Company, each of the Banks and the Hemet Subsidiaries maintain insurance of the types and in the amounts generally deemed adequate for

their respective businesses, including, but not limited to, insurance covering computers and computer and data-processing related equipment and real and personal property owned or leased by the Company or any of the Banks or the Hemet Subsidiaries, against loss, theft, damage, destruction, natural disaster including earthquake, acts of vandalism and all other risks customarily insured against, all of which insurance is in full force and effect.

(x) By December 31, 1999, any software or hardware designed, used, purchased or licensed by the Company, and, to the knowledge of the Company after reasonable investigation, by either of the Banks or the Hemet Subsidiaries, in the course of operation or management of the respective business of each will not contain any deficiency (a) in the ability of such software or hardware to identify correctly or perform calculations or other processing with respect to dates after December 31, 1999 or (b) that would cause such software or hardware to be fit no longer for the purpose for which it was intended by reason of the changing of the date from 1999 to 2000, except in either case as such deficiency would not have a material adverse effect on the Company or either of the Banks.

(y) Neither the Company nor, to the knowledge of the Company after reasonable investigation, either of the Banks or the Hemet Subsidiaries has at any time during the past five years (i) made any unlawful contribution to any candidate for foreign office, or failed to disclose fully any contribution in violation of law, or (ii) made any payment to any federal or state governmental officer or official, or other person charged with similar public or quasi-public duties, other than payments required or permitted by the laws of the United States or any jurisdiction thereof.

(z) All material transactions between the Company and its officers and directors and their respective affiliates have been accurately disclosed in the Prospectus, and the terms of such transactions are fair to the Company; to the knowledge of the Company after reasonable investigation, all material transactions between the Banks and their respective officers and directors and their respective affiliates have been accurately disclosed in the S-4 prospectus;

(aa) The transactions contemplated by the Reorganization Agreements have been consummated in accordance with the terms of the Reorganization Agreements and in compliance with all applicable laws and regulations.

In matters relating to the Banks and Banklink Corporation, the Company

makes the representations and warranties contained in this Section 1 of the Agreement to the knowledge of the Company after reasonable investigation. In matters relating to the Hemet Subsidiaries, other than Banklink Corporation, the Company makes the representations and warranties contained in this Section 1 of the Agreement to the

actual knowledge of the Company.

Any certificate signed by any officer of the Company and delivered to you or to your counsel shall be deemed a representation and warranty by the Company to you as to the matters covered thereby. Any certificate delivered by the Company to its counsel for purposes of enabling such counsel to render the opinions referred to in Section 7(e) will also be furnished to the Underwriter and its counsel and shall be deemed to be additional representations and warranties by the Company to the Underwriter as to the matters covered thereby and the Underwriter and its counsel are entitled to rely thereon.

(B) Each Selling Shareholder severally but not jointly represents and warrants to, and agrees with, the Underwriters, that:

(a) Such Selling Shareholder has full legal right, power and authority to enter into and perform this Agreement, the Power of Attorney in the form heretofore furnished to you (the "Power of Attorney") and the Custody Agreement, Letter of Transmittal, Power of Attorney and Offer of Sale in the form heretofore furnished to you (collectively, the "Custody Agreement"). Each of the Agreement, the Power of Attorney and the Custody Agreement has been duly executed and delivered by such Selling Shareholder, and (assuming this Agreement is a binding agreement of yours) constitutes the valid and binding agreement of such Selling Shareholder, enforceable against such Selling Shareholder in accordance with its respective terms (except as such enforceability may be limited by applicable bankruptcy, insolvency, reorganization, moratorium or other laws of general application relating to or affecting the enforcement of creditors' rights and the application of equitable principles relating to the availability of remedies, and except as rights to indemnity or contribution may be limited by federal or state securities law and the public policy underlying such laws).

(b) None of the execution, delivery or performance of this Agreement, the Power of Attorney and the Custody Agreement and the consummation of the transactions herein or therein contemplated will conflict with or result in a breach of, or default under, any indenture, mortgage, deed of trust, voting trust agreement, shareholders' agreement, note agreement or other agreement or instrument to which such Selling Shareholder is a party or by which such Selling Shareholder is bound or to which any of his or its property is or may be subject, or any statute, judgment, decree, order, rule or regulation applicable to such Selling Shareholder of any government, arbitrator, court, regulatory body or administrative agency or other governmental agency or body, domestic or foreign, having jurisdiction over such Selling Shareholder or any of his activities or properties.

(c) At the date hereof, such Selling Shareholder has full right, power and

authority to sell, assign, transfer and deliver the shares of the common stock of the Banks (and options to purchase shares of the common stock of the Banks) to be surrendered in exchange for the Shares, and at the time of delivery of the Shares to be sold by such Selling Shareholder to the several Underwriters, such Selling Shareholder will have full right, power and authority to sell, assign, transfer and deliver the Shares to be sold by such Selling Shareholder hereunder. At the date hereof such Selling Shareholder is the lawful owner of and has good and marketable title to the shares of the common stock of the Banks (and options to purchase shares of the common stock of the Banks) to be surrendered in exchange for the Shares, free and clear of any and all encumbrances, and at the time of delivery of the Shares to be sold by such Selling Shareholder, such Selling Shareholder will be the lawful owner of and will have good and marketable title to the Shares free and clear of any and all encumbrances.

(d) To such Selling Shareholder's knowledge, such Selling Shareholder has not taken any action designed to stabilize or manipulate the price of any security of the Company, or which has constituted or which might in the future reasonably be expected to cause or result in stabilization or manipulation of the price of any security of the Company, to facilitate the sale or resale of the Shares or otherwise.

(C) Each Valley Major Selling Shareholder severally but not jointly represents and warrants to, and agrees with, the Underwriters, that:

(a) neither the Registration Statement nor any amendment thereto, and neither the Prospectus nor any supplement thereto, contains or will contain, as the case may be, any untrue statement of a material fact with regard to Valley or omits or will omit to state any material fact required to be stated therein with regard to Valley or necessary to make the statements therein with regard to Valley, in light of the circumstances under which they were made, not misleading.

(b) There is not pending, or, to the Valley Major Selling Shareholder's best knowledge, threatened against such Valley Major Selling Shareholder, any action, suit or proceeding which (A) questions the validity of this Agreement or of any action taken or to be taken by such Valley Major Selling Shareholder pursuant to or in connection with this Agreement or (B) is required to be disclosed in the Preliminary Prospectus, the Prospectus or the Registration Statement which is not so disclosed, and such actions, suits or proceedings as are summarized in the Preliminary Prospectus, the Prospectus, the Prospectus, or the Registration Statement, if any, are accurately summarized.

(D) Each Hemet Major Selling Shareholder severally but not jointly represents and warrants to, and agrees with, the Underwriters, that:

(a) neither the Registration Statement nor any amendment thereto, and neither the Prospectus nor any supplement thereto, contains or will contain, as the case may be, any untrue

statement of a material fact with regard to Hemet or omits or will omit to state any material fact required to be stated therein with regard to Hemet or necessary to make the statements therein with regard to Hemet, in light of the circumstances under which they were made, not misleading.

(b) There is not pending, or, to the Hemet Major Selling Shareholder's best knowledge, threatened against such Hemet Major Selling Shareholder, any action, suit or proceeding which (A) questions the validity of this Agreement or of any action taken or to be taken by such Hemet Major Selling Shareholder pursuant to or in connection with this Agreement or (B) is required to be disclosed in the Preliminary Prospectus, the Prospectus or the Registration Statement which is not so disclosed, and such actions, suits or proceedings as are summarized in the Preliminary Prospectus, the Prospectus, the Prospectus, or the Registration Statement, if any, are accurately summarized.

(E) Valley hereby represents and warrants to, and agrees with, each of the Underwriters that:

The representations and warranties made in the Valley Reorganization Agreement are true and correct as of the date of this Agreement.

(F) Hemet hereby represents and warrants to, and agrees with, each of the Underwriters that:

The representations and warranties made in the Hemet Reorganization Agreement are true and correct as of the date of this Agreement.

SECTION 2. Reserved.

SECTION 3. Representations and Warranties of the Underwriters. The Representatives, on behalf of the several Underwriters, represent and warrant to the Company that the information set forth (i) on the cover page of the Prospectus with respect to price, underwriting discounts and commissions and terms of offering and (ii) under the caption "Underwriting" in the Prospectus, was furnished to the Company by and on behalf of the Underwriters for use in connection with the preparation of the Registration Statement and the Prospectus, and such information is correct in all material respects. The Representatives represent and warrant they have been authorized by each of the other Underwriters as the Representatives to enter into this Agreement on behalf of each such Underwriter and to act on behalf of each such Underwriter in the manner herein provided.

SECTION 4. Purchase, Sale and Delivery of Common Shares; Commission

(a) On the basis of the representations, warranties, covenants and

agreements herein contained, but subject to the terms and conditions herein set forth, the Company and each Selling Shareholder agrees, severally and not jointly, to sell to each Underwriter, and each Underwriter agrees, severally and not jointly, to purchase from the Company and the Selling Shareholders, the number of Firm Common Shares determined by (1) adding the aggregate number of Firm Common Shares to be sold by the Company and by each of the Selling Shareholders, as set forth opposite their respective names in Schedule B hereto, and then (2) multiplying that sum by a fraction, the numerator of which is the aggregate number of Firm Common Shares to be purchased by such Underwriter as set forth opposite the name of such Underwriter in Schedule A hereto and the denominator of which is the aggregate number of Firm Common Shares to be purchased by all the Underwriters from the Company and the Selling Shareholders hereunder. The purchase price per share to be paid by the several Underwriters shall be \$\_\_\_\_\_ per share. In consideration of the Underwriters' services in making the public offering of the Firm Common Shares, the Company shall pay a fee (the "Underwriting Fee") to the Underwriters of \_\_\_\_\_% of the aggregate purchase price for all of the Firm Common Shares. The fee shall be paid on the First Closing Date and shall be offset against the portion of the purchase price payable to the Company by the Underwriters. The Selling Shareholders shall have no obligation for any portion of the Underwriting Fee and the Underwriters may not offset any portion of the Underwriting Fee against any portion of the aggregate purchase price payable to the Selling Shareholders.

(b) Delivery of certificates for the Firm Common Shares to be purchased by the Underwriters and payment therefor shall be made at the offices of Sutro & Co. Incorporated, 11150 Santa Monica Boulevard, Suite 1500, Los Angeles, California (or such other place as may be agreed upon by the Company and the Representatives) at 6:00 a.m., local time, on the fourth full business day (assuming pricing after 4:30 p.m. New York Time) (unless such time and date are postponed in accordance with the terms of this Agreement) following the date the Registration Statement becomes effective (or, if the Company has elected to rely upon Rule 430A of the Act, the third business day after determination of the initial offering price), or at such other time as shall be agreed upon by you and the Company.

Delivery of certificates for the Firm Common Shares shall be made by or on behalf of the Company to you, for the respective accounts of the several Underwriters, against payment by you, for the accounts of the several Underwriters, of the purchase price therefor by wire transfers payable in same day funds to such account as the Company shall have designated to the Representatives in writing at least two business days prior to the First Closing Date. The certificates for the Firm Common Shares shall be registered in such names and denominations as you shall have requested at least two business days prior to the First Closing Date, and shall be made available for checking and packaging on the business day preceding the First

Closing Date at such location in [New York, New York] as may be designated by you. Time shall be of the essence, and delivery at the time and place specified in this Agreement is a further condition to the obligations of the Underwriters. The time and date of such delivery shall be referred to herein as the "First Closing Date."

(c) On the basis of the representations, warranties and agreements herein contained, but subject to the terms and conditions herein set forth, the Company hereby grants an option to the several Underwriters to purchase, severally and not jointly, up to an aggregate of 525,000 (15% OF FIRM COMMON SHARES) Optional Common Shares at the purchase price per share to be paid by the Underwriters for the Firm Common Shares, for use solely in covering any over-allotments made by the Underwriters for the account of the Underwriters in the sale and distribution of the Firm Common Shares. The option granted hereunder may be exercised at any time (but not more than once) within 30 days after the first date that any of the Common Shares are released by you for sale to the public, upon notice by you to the Company setting forth the aggregate number of Optional Common Shares as to which the Underwriters are exercising the option, the names and denominations in which the certificates for such Optional Common Shares are to be registered and the time and place at which such certificates are to be delivered. Such time of delivery (which may not be earlier than the First Closing Date and being herein referred to as the "Second Closing Date") shall be determined by you, but if at any time other than the First Closing Date shall not be earlier than two nor later than three full business days after delivery of such notice of exercise. The number of Optional Common Shares to be purchased by each Underwriter shall be determined by multiplying the number of Optional Common Shares to be sold by the Company pursuant to such notice of exercise by a fraction, the numerator of which is the number of Firm Common Shares to be purchased by such Underwriter as set forth opposite its name in Schedule A and the denominator of which is \_\_\_\_\_ (subject to such adjustments to eliminate any fractional share purchases as you in your discretion may make). Certificates for the Optional Common Shares being purchased will be made available for checking and packaging on the business day preceding the Second Closing Date at such location in [New York, New York] as may be designated by you. The manner of payment for and delivery of such Optional Common Shares shall be the same as for the Firm Common Shares purchased from the Company as specified in the to preceding paragraphs. At any time before lapse of the option, you may cancel such option by giving written notice of such cancellation to the Company. If the Underwriters purchase any Optional Common Shares, the Company shall pay an additional fee of \_\_\_\_% of the aggregate purchase price of the Optional Common Shares purchased. The fee shall be paid on the Second Closing Date and shall be offset against the portion of the aggregate purchase price for the Optional Common Shares payable to the Company by the Underwriters. Except to the extent modified by the paragraph (c), all provisions of this Agreement relating to the transactions contemplated to occur on the Closing Date for the sale of the Firm Shares shall apply.

(d) You have advised the Company that each Underwriter has

authorized you to accept delivery of its Common Shares, to make payments and receipt therefore. You, individually and not as the Representatives of the Underwriters, may (but shall not be obligated to) make payments for any Common Shares to be purchased by any Underwriter whose funds shall not have been received by you by the First Closing Date or the Second Closing Date, as the case may be, for the account of such Underwriter, but any such payment shall not relieve such Underwriter from any of its obligations under this Agreement.

(e) Subject to the terms and conditions hereof, the Underwriters propose to make a public offering of their respective portions of the Common Shares as soon after the effective date of the Registration Statement as in your judgment is advisable and at the public offering price per share (the "Offering Price") set forth on the cover page of and on the terms set forth in the final prospectus, if one is used, or on the first page of the Term Sheet, if one is used.

#### SECTION 5. Covenants of the Company and the Selling Shareholders.

The Company hereby covenants and agrees that:

(a) The Company will use its best efforts to cause the Registration Statement and any amendment thereof, if not effective at the time and date that this Agreement is executed and delivered by the parties hereto, to become effective. If the Registration Statement has become or becomes effective pursuant to Rule 430A of the Rules and Regulations, or the filing of the Prospectus is otherwise required under Rule 424(b) of the Rules and Regulations, the Company will file the Prospectus, properly completed, pursuant to the applicable paragraph of Rule 424(b) of the Rules and Regulations within the time period prescribed and will provide evidence satisfactory to you of such timely filing. The Company will promptly advise you in writing (i) of the receipt of any comments of the Commission, (ii) of any request of the Commission for amendment of or supplement to the Registration Statement (either before or after it becomes effective), any Preliminary Prospectus or the Prospectus or for additional information, (iii) when the Registration Statement shall have become effective and (iv) of the issuance by the Commission of any stop order suspending the effectiveness of the Registration Statement or of the institution of any proceedings for that purpose. If the Commission shall enter any such stop order at any time, the Company will use all commercially reasonable efforts to obtain the lifting of such order at the earliest possible time. The Company will not file any amendment or supplement to the Registration Statement (either before or after it becomes effective), any Preliminary Prospectus or the Prospectus if you have not been furnished with a copy a reasonable

time prior to such filing, if you reasonably object to the Company filing such document or if the document to be filed is not in compliance with the Act and the Rules and Regulations.

(b) The Company will prepare and file with the Commission, promptly upon your request, any amendments or supplements to the Registration

Statement or the Prospectus which in your judgment may be necessary or advisable to enable the Underwriters to continue the distribution of the Common Shares and will use its best efforts to cause the same to become effective as promptly as possible. The Company will fully and completely comply with the provisions of Rule 430A of the Rules and Regulations with respect to information omitted from the Registration Statement in reliance upon such Rule.

(c) If at any time during which a prospectus relating to the Common Shares is required to be delivered under the Act, any event occurs, as a result of which the Prospectus, including any amendments or supplements, would include an untrue statement of a material fact, or omit to state any material fact required to be stated therein or necessary to make the statements therein not misleading, or if it is necessary at any time to amend the Prospectus, including any amendments or supplements, to comply with the Act or the Rules and Regulations, the Company will promptly advise you thereof and will promptly prepare and file with the Commission, at its own expense, an amendment or supplement, which will correct such statement or omission or an amendment or supplement which will effect such compliance and will use its best efforts to cause the same to become effective as soon as possible.

(d) During such period as a prospectus is required by law to be delivered in connection with sales by an Underwriter or dealer, the Company, at its expense, will furnish to you or mail to your order copies of the Registration Statement, the Prospectus, the Preliminary Prospectus and all amendments and supplements to any such documents in each case as soon as available and in such quantities as you may reasonably request, for the purposes contemplated in the Act.

(e) As soon as practicable, but not later than 50 days after the end of the first quarter ending after the first anniversary of the effective date of the Registration Statement (as defined in Rule 158(c) of the Rules and Regulations), the Company will make generally available to its security holders an earnings statement (which need not be audited) covering a period of 12 consecutive months beginning after the effective date of the Registration Statement which will satisfy the provisions of the last paragraph of Section 11(a) of the Act.

(f) The Company shall cooperate with you and your counsel to qualify or register the Common Shares for sale under (or obtain exemptions from the

application of) the Blue Sky laws of such jurisdictions as you designate, will comply with such laws and will continue such qualifications, registrations and exemptions in effect so long as reasonably required for the distribution of the Common Shares. The Company shall not be required to qualify as a foreign corporation or to file a general consent to service of process in any such jurisdiction where it is not presently qualified or where



it would be subject to taxation as a foreign corporation. The Company will advise you promptly of the suspension of the qualification or registration of (or any such exemption relating to) the Common Shares for offering, sale or trading in any jurisdiction or any initiation or threat of any proceeding for any such purpose, and in the event of the issuance of any order suspending such qualification, registration or exemption, the Company, with your cooperation, will use its best efforts to obtain the withdrawal thereof.

(g) For a period of five years from the First Closing Date, the Company will furnish to the Representatives: (i) as soon as practicable after the end of each fiscal year, copies of the Annual Report of the Company containing the consolidated balance sheet of the Company as of the close of such fiscal year and consolidated statements of income, shareholders' equity and cash flows for the year then ended and the opinion thereon of the Company's independent public accountants; (ii) as soon as practicable after the filing thereof, copies of each proxy statement and annual and other report filed by the Company with the Commission, the NASD or any securities exchange; and (iii) as soon as available, copies of any report or communication of the Company mailed generally to holders of its Common Stock.

(h) During the period of 180 days after the effective date of the Registration Statement, without the prior written consent of Sutro & Co. Incorporated (which consent may be withheld at the sole discretion of Sutro & Co. Incorporated), the Company will not issue, offer, sell or otherwise dispose of any shares of Common Stock of the Company or any securities convertible into or exchangeable for shares of Common Stock of the Company, other than (i) the sale of the Common Shares hereunder; (ii) the issuance of Common Stock of the Company pursuant to the exercise of options under the Company's stock plans disclosed in the Prospectus; (iii) the granting of stock options after the date of the Prospectus under the Company's stock plans disclosed in the Prospectus; (iv) the issuance of warrants and Common Shares to the holders of common stock of Hemet and common stock of Valley, as described in the Prospectus. For purposes of this subsection (h), an offer by the Company to exchange its securities for those of a bank or other financial institution, or a corporation providing services related to the banking industry, or an offer to exchange its securities for the assets of such an entity, shall not constitute an offer to sell the Company's securities and shall not require your consent. The execution of an agreement to acquire such an entity or its assets in exchange for securities of the Company, and the issuance of securities on the completion of the agreement, shall not constitute an offer,

issuance, sale or disposition of the Company's securities for purposes of this subsection (h), provided the shares issues in such transaction are subject to a lock-up agreement or other restriction, in a form reasonably acceptable to you, until the end of the period of the 180 days after the effective date of the Registration Statement.

(i) The Company will apply the net proceeds of the sale of the

Common Shares substantially in accordance with its statements under the caption "Use of Proceeds" in the Prospectus.

(j) The Company will use its best efforts to designate and maintain the Common Stock for quotation on the Nasdaq National Market.

(k) The Company shall comply with all registration, filing and reporting obligations of the Exchange Act which may from time to time be applicable to the Company.

(l) The Company shall make reasonable efforts to acquire and maintain Directors' and Officers' Liability Insurance in reasonable amounts, at reasonable costs and on reasonable terms (which shall include payment of such officers' and directors' costs of defense as and when incurred) from a responsible insurer(s).

(m) The Company will not take, directly or indirectly, any action designed to or that might be reasonably expected to cause or result in stabilization or manipulation of the price of the Common Stock to facilitate the sale or resale of the Common Shares.

You, on behalf of the Underwriters, may, in your sole discretion, waive in writing the performance by the Company of any one or more of the foregoing covenants or extend the time for their performance.

The Selling Shareholders hereby covenant and agree, severally but not jointly,

(a) Each Selling Shareholder will not, directly or indirectly, without the prior written consent of the Representatives, take directly or indirectly and action designed to, or which might in the foreseeable future reasonably be expected, to cause or result in, stabilization or manipulation of the price of any securities of the Company.

(b) Each Selling Shareholder consents to the use of the Prospectus and any amendment or supplement thereto by the Underwriters and all dealers to whom the Shares may be sold, both in connection with the offering or sale of the

Shares and for such period of time thereafter as the Prospectus is required to be delivered in connection therewith.

(c) Each Major Selling Shareholder will not, directly or indirectly, without the prior written consent of the Representatives, offer, sell, grant any option to purchase or otherwise dispose (or announce any offer, sale, grant of any option to purchase or other disposition) of any shares of Common Stock or any securities convertible into, or exchangeable or exercisable for, shares of Common Stock, for a period of 90 days after the date hereof.

SECTION 6. Payment of Expenses. Whether or not the transactions contemplated hereunder are consummated or this Agreement becomes effective or is terminated, the Company agrees to pay all costs, fees and expenses incurred in connection with the performance of its obligations hereunder and in connection with the transactions contemplated hereby, including without limiting the generality of the foregoing: (i) all expenses incident to the issuance and delivery of the Common Shares (including all printing and engraving costs), (ii) all fees and expenses of the registrar and transfer agent of the Common Stock, (iii) all necessary issue, transfer and other taxes in connection with the issuance and sale of the Common Shares to the Underwriters, (iv) all fees and expenses of counsel and independent accountants of the Company, (v) all fees and expenses of counsel to the Underwriters for legal fees incurred in connection with qualifying or registering (or obtaining exemptions from the qualification or registration of) all or any part of the Common Shares for offer and sale under the United States state "Blue-Sky" laws; (vi) all fees and reasonable out-of-pocket expenses of counsel to the Underwriters for legal fees incurred other than as described in (v) above; (vii) all costs and expenses incurred in connection with the printing, filing, shipping and distribution of the Registration Statement, each Preliminary Prospectus and the Prospectus (including all exhibits and financial statements) and all amendments and supplements provided for herein, this Agreement, the Agreement Among Underwriters, the Selected Dealers Agreement, the Underwriters' Questionnaire, the Underwriters' Power of Attorney, the Preliminary and the Final Blue Sky Memoranda, (viii) all filing fees incurred by the Company or the Underwriters in connection with qualifying or registering (or obtaining exemptions from the qualification or registration of) all or any part of the Common Shares for offer and sale under the U.S. state Blue Sky laws, (ix) the NASD and any fees and expenses relating to the inclusion of the Common Shares on the Nasdaq National Market, (x) all other fees, costs and expenses referred to in Item 13 of the Registration Statement, and (xi) all of your out-of-pocket expenses up to an aggregate of \$15,000, unless we consent to a higher amount.

Except as provided in this Section 6, Section 8 and Section 10 hereof, the Underwriters shall pay all of their own expenses, including the fees and disbursements of their counsel (excluding those relating to (i) fees and expenses of counsel and (ii) qualification, registration or exemption under the securities and Blue

Sky laws and the Blue Sky Memoranda referred to above).

SECTION 7. Conditions of the Obligations of the Underwriters. The obligations of the several Underwriters to purchase and pay for the Firm Common Shares on the First Closing Date and the Optional Common Shares on the Second Closing Date shall be subject to the accuracy of the representations and warranties on the part of the Company and the Selling Shareholders herein set forth as of the date hereof and as of the First Closing Date or the Second Closing Date, as the case may be, to the accuracy of the statements of the Company and the Selling Shareholders made pursuant to the provisions

hereof, to the performance by the Company and the Selling Shareholders of their obligations hereunder, and to the following additional conditions:

(a) The Registration Statement shall have become effective not later than 5:00 P.M. (or in the case of a registration statement filed pursuant to Rule 462(b) of the Rules and Regulations relating to the Common Shares, not later than 10:00 P.M.), Washington, D.C. time, on the date of this Agreement, or at such later time as shall have been consented to by you; if the filing of the Prospectus, or any supplement thereto, is required pursuant to Rule 424(b) of the Rules and Regulations, the Prospectus shall have been filed in the manner and within the time period required by Rule 424(b) of the Rules and Regulations; the Form 8-A shall have become effective pursuant to the Exchange Act and the Rules and Regulations; and prior to such Closing Date, no stop order suspending the effectiveness of the Registration Statement or the Form 8-A shall have been issued and no proceedings for that purpose shall have been instituted or shall be pending or, to the knowledge of the Company or you, shall be contemplated by the Commission; and any request of the Commission for inclusion of additional information in the Registration Statement, or otherwise, shall have been complied with to your satisfaction.

(b) Since the respective dates as of which information is given in the Registration Statement and Prospectus, (i) except as set forth in or contemplated by the Registration Statement or the Prospectus, there shall not have been any change in the capital stock of the Company or any material change in the indebtedness (other than in the ordinary course of business) of the Company, the Company Subsidiaries, either of the Banks or the Hemet Subsidiaries, (ii) except as set forth in or contemplated by the Registration Statement or the Prospectus, no material verbal or written agreement or other transaction shall have been entered into by the Company, the Company Subsidiaries, either of the Banks or the Hemet Subsidiaries, which is not in the ordinary course of business or which could reasonably be expected to result in a material reduction in the future earnings of the Company or either of the Banks, (iii) no loss or damage (whether or not insured) to the property of the Company, either of the Banks or the Hemet Subsidiaries shall have been sustained which materially and adversely

affects the condition (financial or otherwise), business, properties, results of operations or prospects of the Company or either of the Banks, (iv) no legal or governmental action, suit or proceeding affecting the Company, the Company Subsidiaries, either of the Banks or the Hemet Subsidiaries which is material to the Company or either of the Banks, or which affects or may affect the transactions contemplated by this Agreement shall have been instituted or threatened and (v) there shall not have been any material adverse change in the condition (financial or otherwise), business, properties, results of operations or prospects of the Company, the Banks or the Hemet Subsidiaries, which makes it impractical or inadvisable in your reasonable judgment to proceed with the public offering or purchase the Common Shares as contemplated hereby.

(c) There shall have been delivered to you the Firm Common Shares and, if any Optional Common Shares are then being purchased, such Optional Common Shares.

(d) The NASD, upon review of the terms of the public offering of the Common Shares, shall not have objected to the fairness and reasonableness of the underwriting terms and arrangements as proposed in this Agreement.

(e) There shall have been furnished to you, as Representatives of the Underwriters on each Closing Date, in form and substance reasonably satisfactory to you, except as otherwise expressly provided below:

(i) An opinion of Morrison & Foerster, LLP counsel for the Company, addressed to the Underwriters and dated the First Closing Date or the Second Closing Date, as the case may be, to the effect that:

(1) The Company, the Company Subsidiaries and, to such counsel's knowledge, each of the Banks and the Hemet Subsidiaries, has been duly organized and is validly existing in good standing under the laws of its jurisdiction of incorporation, with corporate power to own its properties and assets, to carry on its business as described in the Prospectus, and, as to the Company, to enter into this Agreement and to perform its obligations under this Agreement. The Company and, to such counsel's knowledge, the Banks and the Hemet Subsidiaries are not required to be qualified to do business as a foreign corporation in any jurisdiction, except for Valley, which is qualified to do business in Oregon.

(2) The authorized and outstanding capital stock of the Company is as set forth under the caption "Capitalization" in the Prospectus; the Common Stock and the preferred stock of the Company conform in all material respects to the description thereof contained in the Prospectus; all of the

outstanding securities of the Company have been duly authorized by all necessary corporate action on the part of the Company and are validly issued, fully paid and non-assessable.

(3) The statements in the Prospectus under the caption "Description of Capital Stock," insofar as they summarize provisions of the Articles of Incorporation and Bylaws of the Company, and the statements in the Prospectus under the caption "Supervision and Regulation," insofar as they summarize matters of law, fairly present the information required by Form S-1.

(4) To the best of their knowledge, the outstanding shares of the capital stock of each of the Banks and the Hemet Subsidiaries, have been duly authorized by all necessary corporate action on the part of each

such corporation, are validly issued, fully paid and non-assessable;

(5) Holders of the capital stock of the Company are not entitled to any preemptive right, subscription right or similar right to subscribe to any additional shares of the Company's capital stock under the Company's Articles of Incorporation or Bylaws or any other agreement.

(6) The Registration Statement has become effective under the Act and the Form 8-A has become effective under the Exchange Act and, to such counsel's knowledge, no stop order suspending the effectiveness of the Registration Statement or the Form 8-A has been issued or threatened by the Commission. Such counsel has reviewed the statements set forth in the Registration Statement and Prospectus under the headings "Risk Factors--Government regulation may impair our operations or restrict our growth;" "Risk Factors--We face potential exposure to legal expenses and damages in a lawsuit," "Risk Factors--Our ability to pay dividends is limited;" "Risk Factors--Bank regulatory laws could discourage changes in our ownership" "Risk Factors--Provisions in our charter

documents and agreements we have made will delay or prevent changes in control of our corporation or our management;" "The Acquisitions;" "Business of Pacific Community Banking Group--Supervision and Regulation;" "Business of Pacific Community Banking Group--Litigation;" "Business of the Bank of Hemet--Supervision and Regulation;" "Business of the Bank of Hemet--Litigation;" "Business of Valley Bank--Supervision and Regulation;" "Business of Valley Bank--Litigation;" "Supervision and Regulation;" "Description of Capital Stock;" "Shares Eligible for Future Sale;" and "Additional Information" and, to the extent they constitute a summary of legal matters, documents or proceedings, such statements accurately summarize in all material respects, the information called for with respect to such legal matters, documents and proceedings under the 1933 Act and 1933 Act Regulations.

(7) The Registration Statement and each amendment thereto, on the date it was filed, complied in all material respects with the requirements for registration statements on Form S-1 under the Act and the Rules and Regulations in effect at the date of filing, except such counsel need express no opinion concerning the financial statements and other financial information contained therein; any required filing of a Registration Statement or Prospectus has been made in the manner and within the time period required by the Rules and Regulations and no stop order suspending the use of the Prospectus or any Registration Statement has been issued, and, to the knowledge of such counsel, no proceedings for the purpose has been instituted or contemplated under the Rules and Regulations; the descriptions contained and summarized in the Registration Statement and in the Prospectus of contracts and other documents, are accurate and fairly describe in all material respects such contracts or documents; to the knowledge of such counsel, there are no contracts or

documents which are required by the Rules and Regulations to be described in the Registration Statement or Prospectus or to be filed as exhibits to the Registration Statement which are not described or filed as required by the Rules and Regulations; there is not pending or threatened against the Company or, to the knowledge of such counsel after reasonable investigation, either of the Banks any action, suit,

proceeding or investigation before or by any court, regulatory body, or administrative agency or any other governmental agency or body, domestic or foreign, of a character required to be disclosed in the Registration Statement or Prospectus which is not so disclosed therein.

(8) Such counsel does not know of any contract or other document of a character required to be filed as an exhibit to the Registration Statement which is not filed as required.

(9) The execution, delivery and performance of this Agreement, the Hemet Reorganization Agreement and the Valley Reorganization Agreement have been duly authorized by all necessary corporate action on the part of the Company, and this Agreement, the Hemet Reorganization Agreement and the Valley Reorganization Agreement have been duly executed and delivered by the Company; and this Agreement, the Hemet Reorganization Agreement and the Valley Reorganization Agreement are valid and binding agreements of the Company enforceable in accordance with their respective terms, and the transactions contemplated by the Reorganization Agreements have been consummated.

(10) No order, consent, permit or approval by any California or federal governmental authority is required on the part of the Company for the execution and delivery of this Agreement, or for the issuance and sale of the Common Shares being sold by the Company under this Agreement, except as have been obtained under the Act and as may be required under applicable bank regulatory laws, Blue Sky laws or state securities laws or by the NASD.

(11) The execution and delivery by the Company of this Agreement the Hemet Reorganization Agreement and the Valley Reorganization Agreement, and the performance of the Company's obligations on or prior to the date of this opinion under this Agreement do not (i) violate or conflict with any state or federal statute, rule or regulation of any regulatory body, administrative agency or other governmental agency or body that such counsel has, in the exercise of customary professional diligence, recognized as applicable to the Company or to transactions of the type contemplated by this Agreement, except that such counsel need express no opinion regarding any federal securities laws, the Blue Sky or state securities laws or with respect to Section 10 of this Agreement, except as otherwise expressly stated in such counsel's opinion and no consent, approval, authorization or order of any court, regulatory body or

administrative agency or

other governmental agency or body, domestic or foreign, has been or is required for the Company's performance of this Agreement or the consummation of the transactions contemplated hereby, except such as have been obtained under the Rules and Regulations or may be required under state securities or Blue Sky laws in connection with the purchase and distribution by the underwriter of the Shares; or (ii) violate, breach or result in a default under the articles or certificates of incorporation or bylaws of the Company or under any of the agreements, instruments, contracts, orders, injunctions or judgments binding on the Company or which may be affected by the issuance of capital stock of the Company; or will result in the creation or imposition of any lien, charge or encumbrance upon, any property or assets of the Company or the Banks;

(12) To such counsel's knowledge, the conduct of the business of the Company and the Banks, respectively, as described in the Preliminary Prospectus, the Prospectus and Registration Statement is not in violation of any federal or state statute, administrative regulation or other law, and the Company and the Banks have each obtained all licenses, permits, franchises, certificates and other authorizations from state, federal and other regulatory authorities as are necessary or required for the ownership, leasing and operation of their respective properties and the conduct of their respective businesses as presently conducted and as contemplated in the Prospectus and the Registration Statement; the Company is duly licensed by the Federal Reserve Board as a bank holding company; each of the Banks is duly licensed by the California Department of Financial Institutions to engage in the business of banking and to conduct its business as described in the Prospectus

and the Registration Statement, and the deposits of each of the Banks are insured by the Federal Deposit Insurance Corporation up to the maximum amounts allowable under applicable law;

(13) The Company is not an "investment company" within the meaning of the Investment Company Act of 1940, as amended;

(14) The Company has obtained all requisite California and federal governmental and regulatory approvals, orders, consents or permits necessary to consummate the transactions contemplated by the Reorganization Agreements.

Such counsel shall state that in connection with such counsel's participation in the preparation of the Registration Statement, the Preliminary Prospectus and the Prospectus, participation in conferences with officers and representatives of the Company and the Banks, and the independent public accountants of the Company and the Banks, in connection with the preparation of



the Registration Statement, the Preliminary Prospectus and the Prospectus, it does not believe that the Registration Statement as of its effective date contained any untrue statement of a material fact or omitted to state a material fact required to be stated therein, in light of the circumstances under which they were made, or necessary to make the statements therein, in light of the circumstances under which they were made, not misleading, and counsel shall state that it does not believe that the Prospectus as of its date and as of the date of such opinion, contained or contains any untrue statement of a material fact or omitted or omits to state a material fact necessary to make the statements therein, in light of the circumstances under which they were made, not misleading. However, such counsel need express no opinion or belief as to the financial statements contained in the Registration Statement, the Preliminary Prospectus or the Prospectus.

In rendering such opinions, such counsel may rely as to matters of fact, to the extent deemed proper, on certificates of responsible officers of the Company and public officials and the opinion of even date herewith [addressed to you] from Knecht & Hansen. References to the Registration Statement shall include any amendment or supplement thereto at the date of such opinion.

(ii) An opinion of Gary Steven Findley & Associates, as counsel to Bank of Hemet addressed to the Underwriters and dated the First Closing Date to the effect that:

(1) Hemet has been duly organized and is validly existing in good standing under the laws of its jurisdiction of incorporation, with corporate power to own its properties and assets, to carry on its business as described in the Prospectus. The only subsidiaries of Hemet are the Hemet Subsidiaries, all of which are duly organized and validly existing under the laws of their respective jurisdictions of incorporation, with corporate power to own their properties and assets, to carry on their respective businesses as described in the Prospectus. Neither Hemet nor any of the Hemet Subsidiaries is required to be qualified to do business as a foreign corporation in any jurisdiction.

(2) The authorized and outstanding capital stock of Hemet is as set forth in the Bank S-4, including any amendments thereto (the "Bank S-4"); the Common Stock and the preferred stock of Hemet conform in all material respects to the description thereof contained in the Bank S-4; the outstanding shares of the capital stock of Hemet have been duly authorized by all necessary corporate action on the part of Hemet and are validly issued, fully paid and non-assessable.

(3) The statements in the Bank S-4 under the caption "Description of Capital Stock", insofar as they summarize provisions of the Articles of Incorporation and Bylaws of Hemet, and the statements in the Bank S-4 under the caption "Supervision and Regulation" and "Dissenters' Rights of Appraisal", insofar as they summarize matters of law, fairly

present the information required by Bank S-4.

(4) The outstanding shares of the capital stock of the Hemet Subsidiaries have been duly authorized by all necessary corporate action on the part of each such corporation, are validly issued, fully paid and non-assessable.

(5) Holders of the capital stock of Hemet are not entitled to any preemptive right, subscription right or similar right to subscribe to any additional shares of Hemet's capital stock under the Hemet Articles of Incorporation or Bylaws or any other agreement.

(6) The execution, delivery and performance of the Hemet Reorganization Agreement has been duly authorized by all necessary corporate action on the part of Hemet, and the Hemet Reorganization Agreement has been duly executed and delivered by Hemet; and the Hemet Reorganization Agreement is a valid and binding agreement of Hemet enforceable in accordance with its terms.

(7) Hemet has obtained all required orders, consents, permits or approvals of all California or federal governmental authorities required on the part of Hemet for the execution, delivery and consummation of the transactions contemplated by the Hemet Reorganization Agreement.

(8) The performance of Hemet's obligations under the Hemet Reorganization Agreement or prior to the date of this opinion under this Agreement do not (i) violate or conflict with any state or federal statute, rule or regulation of any regulatory body, administrative agency or other governmental agency or body that such counsel has, in the exercise of customary professional diligence, recognized as applicable to Hemet or to transactions of the type contemplated by the Hemet Reorganization Agreement and no consent, approval, authorization or order of any court, regulatory body or administrative agency or other governmental agency or body, domestic or foreign, has been or is required for Hemet's performance under the Reorganization Agreement or the consummation of the transactions contemplated thereby, except such as have been obtained; or (ii) violate, breach or result in a default under the articles of incorporation or bylaws of Hemet or under any of the agreements, instruments, contracts, orders, injunctions or judgments binding on Hemet; or will result in the creation or imposition of any lien, charge or

encumbrance upon, any property or assets of Hemet;

(9) To such counsel's knowledge, the conduct of the business of Hemet and the Hemet Subsidiaries as described in the Prospectus and Registration Statement and the Bank S-4 is not in violation of any federal or state statute, administrative regulation or other law, and Hemet and the Hemet Subsidiaries have obtained all licenses, permits, franchises,

certificates and other authorizations from state, federal and other regulatory authorities as are necessary or required for the ownership, leasing and operation of their respective properties and the conduct of their respective businesses as presently conducted and as contemplated in the Prospectus, the Registration Statement and the Bank S-4; Hemet is duly licensed by the Department of Financial Institutions to engage in the business of banking and to conduct its business as described in the Preliminary Prospectus, the Prospectus and the Registration Statement, and the deposits of Hemet are insured by the Federal Deposit Insurance Corporation up to the maximum amounts allowable under applicable law;

Such counsel shall state that in connection with such counsel's participation in the preparation of the Bank S-4, participation in conferences with officers and representatives of Hemet, and the independent public accountants of Hemet, in connection with the preparation of the Registration Statement, the Prospectus and the Bank S-4, it does not believe that the Registration Statement or the Bank S-4 as of their respective effective dates contained any untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading as relating to Hemet and the Hemet Subsidiaries, and counsel shall state that it does not believe that the Prospectus or the Bank S-4 as of its date and as of the date of such opinion, contained or contains any untrue statement of a material fact or omitted or omits to state a material fact necessary to make the statements therein, in light of the circumstances under which they were made, not misleading as relates to Hemet and the Hemet Subsidiaries. However, such counsel need express no opinion or belief as to the financial statements and other financial information contained in

the Registration Statement or the Prospectus.

In rendering such opinions, such counsel may rely as to matters of fact, to the extent deemed proper, on certificates of responsible officers of Hemet and public officials. References to the Registration Statement shall include any amendment or supplement thereto at the date of such opinion.

(iii) An opinion of Aldrich & Bonnefin, as counsel to Valley, addressed to the Underwriters and dated the First Closing Date to the effect that:

(1) Valley has been duly organized and is validly existing in good standing under the laws of its jurisdiction of incorporation, with corporate power to own its properties and assets, to carry on its business as described in the Prospectus. Valley has no subsidiaries. Valley is not required to be qualified to do business as a foreign corporation in any jurisdiction, except for Oregon.

(2) The authorized and outstanding capital stock of Valley is as set forth in the Registration Statement on the Bank S-4; the Common Stock of Valley conforms in all material respects to the description

thereof contained in the Bank S-4.

(3) The statements in the Bank S-4 under the caption "Description of Capital Stock", insofar as they summarize provisions of the Articles of Incorporation and Bylaws of Valley, and the statements in the Bank S-4 under the caption "Supervision and Regulation" and "Dissenters' Rights", insofar as they summarize matters of law, fairly present the information required by Form S-4.

(4) The outstanding shares of the capital stock of Valley have been duly authorized by all necessary corporate action on the part of Valley, are validly issued, fully paid and non-assessable, except for 7,872 shares issued to Kenneth Ray.

(5) Holders of the capital stock of Valley are not entitled to any subscription right or similar right to subscribe to any additional shares of Valley's capital stock under the Valley Articles of Incorporation or Bylaws or any

other agreement, except for certain preemptive rights.

(6) The execution, delivery and performance of the Valley Reorganization Agreement has been duly authorized by all necessary corporate action on the part of Valley, and the Valley Reorganization Agreement has been duly executed and delivered by Valley; and the Valley Reorganization Agreement is a valid and binding agreement of Valley enforceable in accordance with its terms.

(7) Valley has obtained all required orders, consents, permits or approvals of all California or federal governmental authorities required on the part of Valley for the execution, delivery and consummation of the transactions contemplated by the Valley Reorganization Agreement.

(8) The performance of Valley's obligations under the Valley Reorganization Agreement or prior to the date of this opinion under this Agreement do not (i) violate or conflict with any state or federal statute, rule or regulation of any regulatory body, administrative agency or other governmental agency or body that such counsel has, in the exercise of customary professional diligence, recognized as applicable to Valley or to transactions of the type contemplated by the Valley Reorganization Agreement and no consent, approval, authorization or order of any court, regulatory body or administrative agency or other governmental agency or body, domestic or foreign, has been or is required for Valley's performance under the Reorganization Agreement or the consummation of the transactions contemplated thereby, except such as have been obtained; or (ii) violate, breach or result in a default under the articles of incorporation or bylaws of Valley, except for certain insurance policies that will terminate as a result of the Valley merger, or under any of the agreements, instruments, contracts, orders, injunctions or judgments binding on Valley; or will

result in the creation or imposition of any lien, charge or encumbrance upon, any property or assets of Valley;

(9) To such counsel's knowledge, the conduct of the business of Valley as described in the Prospectus, Registration Statement and the Bank S-4 is not in violation of any federal or state statute, administrative regulation or other law, and Valley has obtained all licenses, permits, franchises, certificates and other authorizations from state, federal and other regulatory authorities as are necessary or required for the ownership, leasing and operation of their respective properties and the conduct of their respective businesses as presently conducted and as contemplated in the Prospectus, the Registration Statement and the Bank S-4; Valley is duly licensed by the California Department of Financial Institutions to engage in the business of banking and to conduct its business as described in the Preliminary Prospectus, the Prospectus and the Registration Statement, and the deposits of Valley are insured by the Federal Deposit Insurance Corporation up to the maximum amounts allowable under applicable law;

Such counsel shall state that in connection with such counsel's participation in the preparation of the Registration Statement and the Prospectus, participation in conferences with officers and representatives of Valley, and the independent public accountants of Valley, in connection with the preparation of the Registration Statement and the Prospectus, it does not believe that the Registration Statement or the Bank S-4 as of their respective effective dates contained any untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading as relating to Valley, and counsel shall state that it does not believe that the Prospectus or the Bank S-4 as of its date and as of the date of such opinion, contained or contains any untrue statement of a material fact or omitted or omits to state a material fact necessary to make the statements therein, in light of the circumstances under which they were made, not misleading as relates to Valley. However, such counsel need express no opinion or belief as to the financial statements and other financial information contained in the Registration Statement, the Prospectus or the Bank S-4.

In rendering such opinions, such counsel may rely as to matters of fact, to the extent deemed proper, on certificates of responsible officers of Valley and public officials. References to the Registration Statement shall include any amendment or supplement thereto at the date of such opinion.

(iv) Such opinion or opinions of Morrison & Foerster, LLP, addressed to the Underwriters, dated the First Closing Date to the effect that:

(1) Assuming the genuineness of signature and capacity of each Selling Shareholder or the Attorney in Fact, as the case may be, (a) each Selling Shareholder has full legal right, power and authority to enter into this Agreement and to sell, assign, transfer and deliver in the manner

provided herein the shares sold by such Selling Shareholder, (b) this Agreement has been duly executed and delivered by such Selling Shareholder, and (c) this Agreement, assuming the due authorization, execution and delivery by each other party hereto and further assuming it is a valid and binding agreement of each of the Underwriters, is a valid and binding agreement of such Selling Shareholder, enforceable against such Selling Shareholder in accordance with its terms (except as may be limited by applicable bankruptcy, insolvency, reorganization, moratorium or other laws now or hereafter in effect relating to or affecting creditors' rights generally and by general principals of equity relating to the availability of remedies and except as rights to indemnity and contribution may be limited by federal or state securities laws and the public policy underlying such laws);

(2) None of the execution, delivery or performance of this Agreement, the Power of Attorney and the Custody Agreement by such Selling Shareholder and the consummation by such Selling Shareholder of the transactions herein and therein contemplated, conflict with or result in a breach of, or default under, any indenture, mortgage, deed of trust, voting trust agreement, shareholders' agreement, note agreement or other agreement or other instrument to which such Selling Shareholder is a party or by which such Selling Shareholder is bound or to which any of the property or any of the Selling Shareholders is subject, or the charter or bylaws of any of the Selling Shareholders that are corporations, and nothing has come to counsel's attention which causes such counsel to believe that such actions will result in any violation of any federal or California law, rule, administrative regulation or

court decree applicable to such Selling Shareholder (other than state securities or blue sky laws or regulations, as to which such counsel need not express any opinion);

(3) A Custody Agreement has been duly executed and delivered by each Selling Shareholder and, assuming the due authorization, execution and delivery of the Power of Attorney and Custody Agreement by the other parties thereto, each constitutes the valid and binding agreement of each Selling Shareholder enforceable in accordance with its terms, except as such enforceability may be limited by applicable bankruptcy, insolvency, reorganization, moratorium or similar laws relating to or affecting creditors' rights generally or by general principles of equity relating to the availability of remedies and except as rights to indemnity or contribution may be limited by federal or state securities laws and the public policy underlying such laws;

(4) Upon the delivery of the Common Shares to be sold hereunder by each Selling Shareholder and payment therefor in accordance with the terms of this Agreement and assuming that each of the Underwriters which has severally purchased such Shares obtains control of such Common Shares without notice of any adverse claim (within the meaning of Section

8303(a) of the Uniform Commercial Code), such Underwriter will have acquired all of the rights of such Selling Shareholder to the Common Shares sold by such Selling Shareholder hereunder, and in addition will have acquired title to such Common Shares free and clear of any adverse claim.

(v) Such opinion or opinions of Manatt, Phelps & Phillips, LLP, counsel for the Underwriters, dated the First Closing Date or the Second Closing Date, as the case may be, with respect to such other matters as you may reasonably require, and the Company shall have furnished to such counsel such documents and shall have exhibited to them such papers and records as they may reasonably request for the purpose of enabling them to pass upon such matters. In connection with such opinions, such counsel may rely on representations or certificates of officers of the Company, the Banks and governmental officials.

(vi) A certificate of the Company executed by the Chief Executive Officer and the Chief Financial Officer of the Company (who may be the same person), dated the First Closing Date or the Second Closing Date, as the case may be, to the effect that:

(1) The representations and warranties of the Company set forth in Section 1 of this Agreement and Article V of both of the Reorganization Agreements were true and correct as of the date of this

Agreement and are true and correct in all material respects (provided, however, that where a representation or warranty is already qualified as to materiality, such materiality qualifier shall be disregarded for purposes of this condition) as of the First Closing Date or the Second Closing Date, as the case may be, and the Company has complied in all material respects with all the agreements and covenants and satisfied in all material respects all the conditions on its part to be performed or satisfied on or prior to such Closing Date, as contained herein and as in the Hemet Reorganization Agreement and the Valley Reorganization Agreement.

(2) The Commission has not issued any order preventing or suspending the use of the Prospectus or any Preliminary Prospectus filed as a part of the Registration Statement or any amendment or supplement thereto; no stop order suspending the effectiveness of the Registration Statement has been issued; and to the best of the knowledge of the respective signers, no proceedings for that purpose have been instituted or are pending or contemplated under the Act.

(3) Each of the respective signers of the certificate has carefully examined the Registration Statement, the Preliminary Prospectus and the Prospectus; in his opinion and to the best of his knowledge, the Registration Statement, the Preliminary Prospectus and the Prospectus and any amendments or supplements

thereto contain all statements required to be stated therein regarding the Company; and neither the Registration Statement nor the Prospectus nor any amendments or supplement thereto includes any untrue statement of a material fact or omits to state any material fact required to be stated therein, in light of the circumstances under which it was made, or necessary to make the statements therein not misleading.

(4) Since the initial date on which the Registration Statement was filed, no agreement, whether written or oral, transaction or event has occurred which should have been set forth in an amendment to the Registration Statement or in a supplement to or amendment of any prospectus which has not been disclosed in such a supplement or amendment.

(5) Since the respective dates as of which information is given in the Registration Statement, the Preliminary Prospectus and the Prospectus, and except as disclosed in or contemplated by the Prospectus, there has not been any material adverse change or a development involving a material adverse change in the condition

(financial or otherwise), business, properties, results of operations, management or prospects of the Company, either of the Banks or the Hemet Subsidiaries; and no legal or governmental action, suit or proceeding is pending or threatened against the Company, either of the Banks or the Hemet Subsidiaries which is material to the Company or either of the Banks, whether or not arising from transactions in the ordinary course of business, or which may adversely affect the transactions contemplated by this Agreement; since such dates and except as so disclosed, neither the Company, or either of the Banks or the Hemet Subsidiaries have entered into any verbal or written agreement or other transaction which could result in a material reduction in the future earnings of the Company or either of the Banks or incurred any material liability or obligation, direct, contingent or indirect, made any change in its capital stock, made any material change in its short-term debt or funded debt or repurchased or otherwise acquired any of the Company's capital stock; and the Company has not declared or paid any dividend, or made any other distribution, upon its outstanding capital stock payable to shareholders of record on a date prior to the First Closing Date or Second Closing Date; and

(6) Since the respective dates as of which information is given in the Registration Statement and the Prospectus and except as disclosed in or contemplated by the Prospectus, none of the Company, the Banks or the Hemet Subsidiaries has sustained a material loss or damage by strike, fire, flood, windstorm, accident or other calamity (whether or not insured). References to the Registration Statement and the Prospectus in this paragraph are to



such documents as amended and supplemented at the date of the certificate.

(vii) A certificate of Hemet executed by the Chief Executive Officer and the Chief Financial Officer of Hemet, dated the First Closing Date to the effect that:

(1) The representations and warranties of Hemet set forth in Article IV of the Hemet Reorganization Agreement were true and correct as of the date of this Agreement and are true and correct in all material respects (provided, however, that where a representation or warranty is already qualified as to materiality, such materiality qualifier shall be disregarded for purposes of this condition) as of the First Closing Date and Hemet has complied in all material respects with all the agreements and covenants and satisfied in all material respects all the conditions on its part to be performed or satisfied on or prior to such First Closing Date, as contained in the Hemet Reorganization Agreement.

(2) Each of the respective signers of the certificate has carefully examined the Registration Statement and the Prospectus and the Hemet S-4; in his opinion and to the best of his knowledge, the Registration Statement, the Prospectus and the Hemet S-4 and any amendments or supplements thereto contain all statements required to be stated therein regarding Hemet; and neither the Registration Statement, the Prospectus or the Hemet S-4 nor any amendments or supplement thereto includes any untrue statement of a material fact or omits to state any material fact required to be stated therein, or necessary to make the statements therein, in light of the circumstances under which it was made, not misleading, as regards Hemet.

(3) Since the initial dates on which the Registration Statement and the Bank S-4 was filed, no agreement to which Hemet is a party, whether written or oral, transaction or event has occurred which should have been set forth in an amendment to the Registration Statement or the Bank S-4 or in a supplement to or amendment of any prospectus which has not been disclosed in such a supplement or amendment.

(4) Since the respective dates as of which information is given in the Registration Statement and the Prospectus, and the Bank S-4 and except as disclosed in or contemplated by the Prospectus, there has not been any material adverse change or a development involving a material adverse change in the condition (financial or otherwise), business, properties, results of operations, management or prospects of Hemet; and no legal or governmental action,

suit or proceeding is pending or threatened against Hemet which is material to Hemet, whether or not arising from transactions in the ordinary course of business, or which may adversely affect the transactions contemplated by this Agreement; since such dates and except as so disclosed, Hemet has not entered into any verbal or written agreement or other transaction which could result in a material reduction in the future earnings of Hemet or incurred any material liability or obligation, direct, contingent or indirect, made any change in its capital stock, made any material change in its short-term debt or funded debt or repurchased or otherwise acquired any of Hemet's capital stock; and, except as described in the Bank S-4, Hemet has not declared or paid any dividend, or made any other distribution, upon its outstanding capital stock payable to shareholders of record on a date prior to the First Closing Date; and

(5) Since the respective dates as of which information is

given in the Registration Statement and the Prospectus and except as disclosed in or contemplated by the Prospectus, Hemet has not sustained a material loss or damage by strike, fire, flood, windstorm, accident or other calamity (whether or not insured). References to the Registration Statement, the Prospectus and the Bank S-4 in this paragraph are to such documents as amended and supplemented at the date of the certificate.

(viii) A certificate of Valley executed by the Chief Executive Officer and the Chief Financial Officer of Valley, dated the First Closing Date to the effect that:

(1) The representations and warranties of Valley set forth in Article IV of the Valley Reorganization Agreement were true and correct as of the date of this Agreement and are true and correct in all material respects (provided, however, that where a representation or warranty is already qualified as to materiality, such materiality qualifier shall be disregarded for purposes of this condition) as of the First Closing Date and Valley has complied in all material respects with all the agreements and covenants and satisfied in all material respects (provided, however, that where a representation or warranty is already qualified as to materiality, such materiality qualifier shall be disregarded for purposes of this condition) all the conditions on its part to be performed or satisfied on or prior to such Closing Date.

(2) Each of the respective signers of the certificate has carefully examined the Registration Statement, the Prospectus and the Bank S-4; in his opinion and to the best of his knowledge, the Registration Statement, the Prospectus and the Bank S-4

and any amendments or supplements thereto contain all statements required to be stated therein regarding Valley; and neither the Registration Statement nor the Prospectus nor any amendments or supplement thereto includes any untrue statement of a material fact or omits to state any material fact required to be stated therein or necessary to make the statements therein not misleading.

(3) Since the initial dates on which the Registration Statement and the Bank S-4 was filed, no agreement to which Valley is a party, whether written or oral, transaction or event has occurred which should have been set forth in an amendment to the Registration Statement or the Bank S-4 or in a supplement to or amendment of any prospectus which has not been disclosed in such a supplement or amendment.

(4) Since the respective dates as of which information is given in the Registration Statement and the Prospectus, and the Bank S-4 and except as disclosed in or contemplated by the Prospectus, there has not been any material adverse change or a development involving a material adverse change in the condition (financial or otherwise), business, properties, results of operations, management or prospects of Valley; and no legal or governmental action, suit or proceeding is pending or threatened against Valley which is material to Valley, whether or not arising from transactions in the ordinary course of business, or which may adversely affect the transactions contemplated by this Agreement; since such dates and except as so disclosed, Valley has not entered into any verbal or written agreement or other transaction which could result in a material reduction in the future earnings of Valley or incurred any material liability or obligation, direct, contingent or indirect, made any change in its capital stock, made any material change in its short-term debt or funded debt or repurchased or otherwise acquired any of Valley's capital stock; and, except as described in the Bank S-4, Valley has not declared or paid any dividend, or made any other distribution, upon its outstanding capital stock payable to shareholders of record on a date prior to the First Closing Date; and

(5) Since the respective dates as of which information is given in the Registration Statement and the Prospectus and except as disclosed in or contemplated by the Prospectus, Valley has not sustained a material loss or damage by strike, fire, flood, windstorm, accident or other calamity (whether or not insured). References to the Registration Statement, the Prospectus and the Valley S-4 in this paragraph are to such documents as amended and supplemented at the date of the certificate.

(ix) A certificate of the [Major] Selling Shareholders (which may be signed by the Attorney-in-Fact for the Selling Shareholders), dated the First

Closing Date, to the effect that:

(1) The representations and warranties of such Selling Shareholder in this Agreement are true and correct, as if made at and as of the First Closing Date or the Second Closing Date, as the case may be, and such Selling Shareholder has complied in all material respects with all the agreements and satisfied all the conditions to be performed or satisfied by such Selling Shareholder at or prior to the First Closing Date; and

(2) The Registration Statement and the Prospectus and, if any,

each amendment and supplement thereto, contain all material statements required to be included therein regarding such [Major] Selling Shareholder, and none of the Registration Statement nor any amendment thereto includes any untrue statement of a material fact regarding such [Major] Selling Shareholder or omits to state any material fact regarding such [Major] Selling Shareholder required to be stated therein or necessary to make the statements therein regarding such [Major] Selling Shareholder in light of the circumstances under which they were made, not misleading.

(x) On the date before this Agreement is executed and also on each Closing Date, a letter addressed to you, as Representatives of the Underwriters, from Arthur Andersen, LP and McGladrey & Pullen, LLP, independent accountants, the first one to be dated the date of this Agreement, the second one to be dated the First Closing Date and the third one (in the event of a second closing hereunder) to be dated the Second Closing Date, in form and substance reasonably satisfactory to you, to the effect that they are independent public accountants with respect to the Company and each of the Banks, respectively, within the meaning of the Act and the related Rules and Regulations, and containing statements and information with respect to the financial statements and certain financial information contained in the Registration Statement and the Prospectus.

(xi) On or before the First Closing Date, letters from each director and executive officer of the Company and each of the Banks, in form and substance reasonably satisfactory to you, (i) confirming that for a period of 90 days from the date of the Prospectus (or 180 days in the case of those persons who are directors of the Company), such person will not, directly or indirectly, offer to sell, contract to sell or otherwise sell, dispose of, loan, pledge or grant any rights or options with respect to (each, a "Disposition") any shares of the Common Stock, any options or warrants to purchase any shares of the Common Stock or any securities convertible into or exercisable or exchangeable for shares of the Common Stock, whether then owned or thereafter acquired by such person or with respect to which such person has or thereafter acquires the power of disposition, or transfer, in any manner, all or a portion of the economic

consequences associated with the ownership of such Common Stock, any options or warrants to purchase any shares of the Common Stock or any securities convertible into or exercisable or exchangeable for shares of the Common Stock, otherwise than (i) as a bona fide gift or gifts, provided the donee or donees thereof agree in writing to be bound by the terms of such letter, (ii) as distribution to partners or shareholders of such person, provided that the distributees thereof agree in writing to be bound by the terms of such letter, or (iii) with the prior written consent of the Representatives.

(f) On or before the date any of the Common Shares are released by the Representatives for sale to the public and on the First Closing Date, the Common Shares shall be authorized for quotation on the Nasdaq National Market.

(g) The Common Shares shall be qualified for sale in such States and jurisdictions as the Representatives may reasonably request, each such qualification shall be in effect and not subject to any stop order or other proceeding on the First Closing Date and the Second Closing Date;

(h) Reserved

(i) On the First Closing Date or the Second Closing Date, as the case may be, the Underwriters shall have received a certificate, executed by the Secretary of the Company, dated as of the Closing Date or the Option Closing Date, as the case may be, certifying the authenticity of attached copies of the Company's Articles of Incorporation, as amended, Bylaws, as amended, and resolutions of the Board of Directors approving the transactions contemplated hereby.

(j) The transactions contemplated by the Reorganization Agreements shall have been consummated.

All such opinions, certificates, letters and documents shall be in compliance with the provisions hereof only if they are reasonably satisfactory to you and to Manatt, Phelps & Phillips, LLP, counsel for the Underwriters. The Company shall furnish you with such manually signed or conformed copies of such opinions, certificates, letters and documents as you request.

If any condition to the Underwriters' obligations hereunder to be satisfied prior to or at the First Closing Date is not so satisfied, this Agreement at your election will terminate upon notification by you to the Company without liability on the part of you or any Underwriter or the Company except for the expenses to be paid or reimbursed by the Company pursuant to Sections 6 and 8 hereof and except to the extent provided in Section 10 hereof.

SECTION 8. Reimbursement of Underwriters' Expenses. Notwithstanding any other provisions hereof, if this Agreement shall be terminated by you pursuant to Section 7 or Section 13(a) or (b) or if the sale to the Underwriters

of the Firm Common Shares at the First Closing Date is not consummated because of any refusal, inability or failure on the part of the Company to perform any agreement herein or to comply with any provision hereof, the Company agrees to reimburse you and the other Underwriters upon demand for all out-of-pocket expenses that shall have been

reasonably incurred by them in connection with the proposed purchase and the sale of the Firm Common Shares, including but not limited to reasonable fees and disbursements of counsel, printing expenses, travel expenses, postage and telephone charges relating directly to the offering contemplated by the Prospectus up to a maximum of \$175,000. Any such termination shall be without liability of any party to any other party except that the provisions of this Section and Section 6 and Section 10 hereof shall at all times be effective and shall apply.

SECTION 9. Effectiveness of Registration Statement. You and the Company will use your and its respective best efforts to cause the Registration Statement to become effective, to prevent the issuance of any stop order suspending the effectiveness of the Registration Statement and, if such stop order be issued, to obtain as soon as possible the lifting thereof.

SECTION 10. Indemnification and Contribution.

(a) The Company and the Major Selling Shareholders jointly and severally agree to (i) indemnify and hold harmless each Underwriter and each person, if any, who controls any Underwriter within the meaning of the Act, against any losses, claims, damages, liabilities or expenses, joint or several (and actions in respect thereof), to which such Underwriter or such controlling person may become subject, under the Act, the Securities Exchange Act of 1934, as amended (the "Exchange Act"), the Rules and Regulations or other federal or state statutory law or regulation, or at common law or otherwise (including in settlement of any litigation, if such settlement is effected with the written consent of the Company and the Major Selling Shareholders), insofar as such losses, claims, damages, liabilities or expenses (or actions in respect thereof as contemplated below) arise out of or are based upon any untrue statement or alleged untrue statement of any material fact contained in the Registration Statement, any Preliminary Prospectus, the Prospectus, or any amendment or supplement thereto, or any Blue Sky application or other document executed by the Company or the Major Selling Shareholders filed in any state or other jurisdiction in order to qualify any or all of the shares of Common Stock offered hereby or arise out of or are based upon the omission or alleged omission to state in any of them a material fact required to be stated therein or necessary to make the statements in any of them not misleading, or arise out of or are based in whole or in part on any inaccuracy in the representations and warranties of the Company or the Major Selling Shareholders contained herein or any failure

of the Company or the Major Selling Shareholders to perform their obligations hereunder or under law; and (ii) reimburse each Underwriter and each such controlling person for any legal and other expenses as such expenses are reasonably incurred by such Underwriter or such controlling person in connection with investigating, defending, settling, compromising, appearing as a third-party witness or paying any such loss, claim, damage, liability, expense or action; provided, however, that the

Company and the Major Selling Shareholders will not be liable in any such case to the extent that any such loss, claim, damage, liability or expense arises out of or is based upon an untrue statement or alleged untrue statement or omission or alleged omission made (i) in the Registration Statement, any Preliminary Prospectus, the Prospectus, or any amendment or supplement thereto, in reliance upon and in conformity with the information furnished to the Company pursuant to Section 3 hereof; or (ii) in any Preliminary Prospectus if a copy of the Prospectus (or the Prospectus as then amended or supplemented) was not sent or given by or on behalf of the Underwriters to such person at or prior to the written confirmation of the sale of such Common Shares to such person in any case where such delivery is required by the Act, such untrue statement contained in or omission from such Preliminary Prospectus was corrected in the Prospectus (or the Prospectus as so amended or supplemented) and the Company had previously furnished copies of such corrected Prospectus to the Underwriters.

In addition to its other obligations under this Section 10(a), the Company and the Major Selling Shareholders jointly and severally agree that, as an interim measure during the pendency of any claim, action, investigation, inquiry or other proceeding arising out of or based upon any untrue statement or omission, or any alleged untrue statement or omission, or any inaccuracy in the representations and warranties of the Company or the Major Selling Shareholder or any failure to perform their respective obligations hereunder, all as described in this Section 10(a), the Company and the Major Selling Shareholders will reimburse each Underwriter (and to the extent applicable each controlling person) on a quarterly basis for all reasonable legal or other expenses incurred in connection with investigating or defending any such claim, action, investigation, inquiry or other proceeding, notwithstanding the absence of a judicial determination as to the propriety and enforceability of the Company's and the Major Selling Shareholders' obligation to reimburse each Underwriter (and to the extent applicable each controlling person) for such expenses and the possibility that such payments might later be held to have been improper by a court of competent jurisdiction. To the extent that any such interim reimbursement payment is so held to have been improper, each Underwriter (and to the extent applicable each controlling person) shall promptly return it to the Company and the Major Selling Shareholders together with interest, compounded daily, determined on the basis of the prime rate (or other commercial lending rate for borrowers of the highest credit standing) announced from time to time by Bank of America, (the "Prime Rate"). Any such interim reimbursement payments

which are not made to an Underwriter within 30 days of a request for reimbursement shall bear interest at the Prime Rate from the date of such request. This indemnity agreement will be in addition to any liability which the Company or the Major Selling Shareholder may otherwise have.

(b) Each Other Selling Shareholder severally, but not jointly, agrees to (i) indemnify and hold harmless each Underwriter and each person, if any, who controls any Underwriter within the meaning of the Act, against any losses, claims, damages,

liabilities or expenses, joint or several (and actions in respect thereof), to which such Underwriter or such controlling person may become subject, under the Act, the Securities Exchange Act of 1934, as amended (the "Exchange Act"), the Rules and Regulations or other federal or state statutory law or regulation, or at common law or otherwise (including in settlement of any litigation, if such settlement is effected with the written consent of the Company and the Other Selling Shareholders), insofar as such losses, claims, damages, liabilities or expenses (or actions in respect thereof as contemplated below) arise out of or are based upon any untrue statement or alleged untrue statement of any material fact contained in the Registration Statement, any Preliminary Prospectus, the Prospectus, or any amendment or supplement thereto, or any Blue Sky application or other document executed by the Company or the Other Selling Shareholders filed in any state or other jurisdiction in order to qualify any or all of the shares of Common Stock offered hereby or arise out of or are based upon the omission or alleged omission to state in any of them a material fact required to be stated therein or necessary to make the statements in any of them not misleading, or arise out of or are based in whole or in part on any inaccuracy in the representations and warranties of the Other Selling Shareholders contained herein or any failure of the Other Selling Shareholders to perform their obligations hereunder or under law; and (ii) reimburse each Underwriter and each such controlling person for any legal and other expenses as such expenses are reasonably incurred by such Underwriter or such controlling person in connection with investigating, defending, settling, compromising, appearing as a third-party witness or paying any such loss, claim, damage, liability, expense or action; provided, however, that in any Preliminary Prospectus if a copy of the Prospectus (or the Prospectus as then amended or supplemented) was not sent or given by or on behalf of the Underwriters to such person at or prior to the written confirmation of the sale of such Common Shares to such person in any case where such delivery is required by the Act, such untrue statement contained in or omission from such Preliminary Prospectus was corrected in the Prospectus (or the Prospectus as so amended or supplemented) and the Company had previously furnished copies of such corrected Prospectus to the Underwriters; provided, further, that the obligations of each of the Other Selling Shareholders pursuant to this Section 10(b) shall apply only with respect to information provided by the Other Selling Shareholders. No Other Selling Shareholder shall be required to pay amounts for indemnification, including expenses, under this Section



10(b) which exceed the aggregate net proceeds received by such Other Selling Shareholder from the sale of Shares to the Underwriters.

In addition to its other obligations under this Section 10(b), the Other Selling Shareholders agree that, as an interim measure during the pendency of any claim, action, investigation, inquiry or other proceeding arising out of or based upon any untrue statement or omission, or any alleged untrue statement or omission, or any inaccuracy in the representations and warranties of the Other Selling Shareholder or any failure to perform their respective obligations hereunder, all as described in this

Section 10(b), the Other Selling Shareholders will reimburse each Underwriter (and to the extent applicable each controlling person) on a quarterly basis for all reasonable legal or other expenses incurred in connection with investigating or defending any such claim, action, investigation, inquiry or other proceeding, notwithstanding the absence of a judicial determination as to the propriety and enforceability of the Other Selling Shareholders' obligation to reimburse each Underwriter (and to the extent applicable each controlling person) for such expenses and the possibility that such payments might later be held to have been improper by a court of competent jurisdiction. To the extent that any such interim reimbursement payment is so held to have been improper, each Underwriter (and to the extent applicable each controlling person) shall promptly return it to the Other Selling Shareholders together with interest, compounded daily, determined on the basis of the prime rate (or other commercial lending rate for borrowers of the highest credit standing) announced from time to time by Bank of America, (the "Prime Rate"). Any such interim reimbursement payments which are not made to an Underwriter within 30 days of a request for reimbursement shall bear interest at the Prime Rate from the date of such request. This indemnity agreement will be in addition to any liability which the Other Selling Shareholders may otherwise have.

(c) Each Underwriter agrees to severally but not jointly indemnify and hold harmless the Company, each of its directors, each of its officers who signed the Registration Statement, each Selling Shareholder, and each person, if any, who controls the Company within the meaning of the Act, against any losses, claims, damages, liabilities or expenses to which the Company or any such director, officer or controlling person, or Selling Shareholder, may become subject, under the Act, the Exchange Act or other federal or state statutory law or regulation, or at common law or otherwise (including in settlement of any litigation, if such settlement is effected with the written consent of such Underwriter), insofar as such losses, claims, damages, liabilities or expenses (or actions in respect thereof as contemplated below) arise out of or are based upon any untrue or alleged untrue statement of any material fact contained in the Registration Statement, any Preliminary Prospectus, the Prospectus, or any amendment or supplement thereto, or arise out of or are based upon the omission or alleged

omission to state therein a material fact required to be stated therein or necessary to make the statements in any of them not misleading, in each case to the extent, but only to the extent, that such untrue statement or alleged untrue statement or omission or alleged omission was made in the Registration Statement, any Preliminary Prospectus, the Prospectus, or any amendment or supplement thereto, in reliance upon and in conformity with the information furnished to the Company as described in Section 3 hereof; and will reimburse the Company and each such director, officer or controlling person for any legal and other expenses, as such expenses are reasonably incurred by the Company or any such director, officer or controlling person, or any Selling Shareholder, in connection with investigating, defending, settling, compromising or paying any such loss, claim, damage, liability, expense or action. In addition to its

other obligations under this Section 10(c), each Underwriter severally agrees that, as an interim measure during the pendency of any claim, action, investigation, inquiry or other proceeding arising out of or based upon any untrue statement or omission, or any alleged untrue statement or omission, described in this Section 10(c) which relates to information furnished to the Company as described in Section 3 hereof; it will reimburse the Company and each such officer, director or controlling person, and Selling Shareholder, on a quarterly basis for all reasonable legal or other expenses incurred in connection with investigating or defending any such claim, action, investigation, inquiry or other proceeding, notwithstanding the absence of a judicial determination as to the propriety and enforceability of the Underwriters' obligation to reimburse the Company and each such officer, director or controlling person and Selling Shareholder for such expenses and the possibility that such payments might later be held to have been improper by a court of competent jurisdiction. To the extent that any such interim reimbursement payment is so held to have been improper, the Company and each such officer, director or controlling person and Selling Shareholder shall promptly return it to the Underwriters, together with interest, compounded daily, determined on the basis of the Prime Rate. Any such interim reimbursement payments which are not made to the appropriate person within 30 days of a request for reimbursement shall bear interest at the Prime Rate from the date of such request. This indemnity agreement will be in addition to any liability which the Underwriters may otherwise have.

(d) Promptly after receipt by an indemnified party under this Section of notice of the commencement of any action, such indemnified party will, if a claim in respect thereof is to be made against an indemnifying party under this Section, notify the indemnifying party in writing of the commencement thereof; but the omission so to notify the indemnifying party will not relieve it from any liability which it may have to any indemnified party otherwise than under the indemnity agreement contained in this Section or to the extent it is not prejudiced as a proximate result of such failure. In case any such action is brought against any indemnified party and such indemnified party seeks or intends to seek indemnity from an indemnifying party, the indemnifying party will be entitled to participate in, and, to the extent that it may wish, jointly

with all other indemnifying parties similarly notified, to assume the defense thereof with counsel reasonably satisfactory to such indemnified party; provided, however, if the defendants in any such action include both the indemnified party and the indemnifying party and the indemnified party shall have reasonably concluded that there may be a conflict between the positions of the indemnifying party and the indemnified party in conducting the defense of any such action or that there may be legal defenses available to it and/or other indemnified parties which are different from or additional to those available to the indemnifying party, the indemnified party or parties shall have the right to select separate counsel to assume such legal defenses and to otherwise participate in the defense of such action on behalf of such indemnified party or parties. Upon receipt of notice from the indemnifying party to such indemnified party of its election so to assume the defense of such action and approval by the indemnified party of counsel, the

indemnifying party will not be liable to such indemnified party under this Section for any legal or other expenses subsequently incurred by such indemnified party in connection with the defense thereof unless (i) the indemnified party shall have employed such counsel in connection with the assumption of legal defenses in accordance with the provisions of this paragraph (it being understood, however, that the indemnifying party shall not be liable for the expenses of more than one separate counsel, approved by the Underwriters in the case of paragraphs (a) and (b) of this Section 10, representing the indemnified parties who are parties to such action); (ii) the indemnifying party shall not have employed counsel reasonably satisfactory to the indemnified party to represent the indemnified party within a reasonable time after notice of commencement of the action, in each of which cases the reasonable fees and expenses of counsel shall be at the expense of the indemnifying party; or (iii) the indemnifying party has authorized in writing the employment of counsel for the indemnified party at the expense of the indemnifying party. An indemnifying party shall not be liable for any settlement of any action, suit, proceeding or claim effected without its written consent, which will not be unreasonably withheld.

(e) If the indemnification provided for in this Section 10 is required by its terms but is for any reason held to be unavailable to hold harmless an indemnified party under subsections (a), (b), (c) or (d) of this Section 10 in respect of any losses, claims, damages, liabilities or expenses referred to herein, then each indemnifying party shall contribute to the amount paid or payable by such indemnified party as a result of any losses, claims, damages, liabilities or expenses (or actions in respect thereof) referred to herein in such proportion as is appropriate to reflect the relative benefits received by the Company and/or the Selling eShareholders and the Underwriters from the offering of the Common Shares and the relative fault of the Company and/or the Selling Shareholders and the Underwriters in connection with the statements or omissions which resulted in such losses, claims, damages, liabilities or expenses, as well as any other relevant equitable considerations. The respective relative benefits received by the Company and/or the Selling Shareholders and the Underwriters shall be deemed

to be in the same proportion, in the case of the Company, as the total price paid to the Company for the Common Shares sold by it to the Underwriters (net of underwriting commissions but before deducting expenses), and in the case of the Selling Shareholders, as the total price paid to the Selling Shareholders for the Common Shares sold by it to the Underwriters (net of underwriting commissions but before deducting expenses) and, in the case of the Underwriters, as the underwriting commissions received by them, bears to the total of such amounts paid to the Company and the amounts received by the Underwriters as underwriting commissions. The relative fault of the Company and/or the Selling Shareholders and the Underwriters shall be determined by reference to, among other things, whether the untrue or alleged untrue statement of a material fact or the omission or alleged omission to state a material fact relates to information supplied by the Company or the Selling

Shareholders or the Underwriters and the parties' relative intent, knowledge, access to information and opportunity to correct or prevent such untrue statement or omission. The amount paid or payable by a party as a result of the losses, claims, damages, liabilities and expenses referred to above shall be deemed to include, subject to the limitations set forth in subsection (d) of this Section 10, any legal or other fees or expenses reasonably incurred by such party in connection with investigating or defending any action or claim.

The provisions set forth in subsection (d) of this Section 10 with respect to notice of commencement of any action shall apply if a claim for contribution is to be made under this subsection (e); provided, however, that no additional notice shall be required with respect to any action for which notice has been given under subsection (d) for purposes of indemnification. The Company and the Underwriters agree that it would not be just and equitable if contribution pursuant to this Section 10 were determined solely by pro rata allocation (even if the Underwriters were treated as one entity for such purpose) or by any other method of allocation which does not take account of the equitable considerations referred to in the immediately preceding paragraph. Notwithstanding the provisions of this Section 10, no Underwriter shall be required to contribute any amount in excess of the amount of the total underwriting commissions received by such Underwriter in connection with the Common Shares underwritten by it. No person guilty of fraudulent misrepresentation (within the meaning of Section 11(f) of the Act) shall be entitled to contribution from any person who was not guilty of such fraudulent misrepresentation. The Underwriters' obligations to contribute pursuant to this Section 10 are several in proportion to their respective underwriting commitments and not joint.

(f) It is agreed that any controversy arising out of the operation of the interim reimbursement arrangements set forth in Sections 10(a), 10(b) and 10(c) hereof, including the amounts of any requested reimbursement payments and the method of determining such amounts, shall be settled by arbitration conducted under the provisions of the Code of Arbitration Procedure of the NASD, as applicable. Any such arbitration must be commenced by service of a written

demand for arbitration or written notice of intention to arbitrate, therein selecting the arbitration tribunal. In the event the party demanding arbitration does not make such designation of an arbitration tribunal in such demand or notice, then the party responding to said demand or notice is authorized to do so. Such an arbitration would be limited to the operation of the interim reimbursement provisions contained in Sections 10(a), 10(b) and 10(c) hereof and would not resolve the ultimate propriety or enforceability of the obligation to reimburse expenses which is created by the provisions of such Sections 10(a), 10(b) and 10(c) hereof.

SECTION 11. Default of Underwriters. It shall be a condition to this

Agreement and the obligations of the Company to sell and deliver the Common Shares hereunder, and of each Underwriter to purchase the Common Shares in the manner as described herein, that, except as hereinafter in this paragraph provided, each of the Underwriters shall purchase and pay for all the Common Shares agreed to be purchased by such Underwriter hereunder upon tender to the Underwriters of such shares in accordance with the terms hereof. If applicable, if any Underwriter or Underwriters default in their obligations to purchase Common Shares hereunder on either the First or Second Closing Date, and the aggregate number of Common Shares which such defaulting entity agreed but failed to purchase on such Closing Date does not exceed 10% of the total number of Common Shares which the Underwriters are obligated to purchase on such Closing Date, the nondefaulting entities shall be obligated severally, in proportion to their respective commitments hereunder, to purchase the Common Shares which such defaulting entities agreed but failed to purchase on such Closing Date. If any Underwriter or Underwriters so default and the aggregate number of Common Shares with respect to which such default occurs is more than the above percentage, and arrangements satisfactory to you and the Company for the purchase of such Common Shares by other persons are not made within two full business days after such default, this Agreement will terminate without liability on the part of any nondefaulting Underwriter or the Company, except for the expenses to be paid by the Company pursuant to Section 6 hereof and except to the extent provided in Section 10 hereof.

If applicable, in the event that Common Shares to which a default relates are to be purchased by a nondefaulting Underwriter or by another person or persons, the Representatives shall have the right to postpone the First or Second Closing Date, as the case may be, for not more than five business days in order that the necessary changes in the Registration Statement, Prospectus, this Agreement and any other documents, as well as any other arrangements, may be effected. As used in this Agreement, the term "Underwriter" includes any person substituted for an Underwriter under this Section. Nothing herein will relieve a defaulting Underwriter from liability for its default.

SECTION 12. Effective Date. This Agreement shall become effective immediately as to Sections 6, 8, 10, 13 and 14 hereof and, as to all other provisions, (i) if at the time of execution of this Agreement the Registration Statement has not become effective, at 6:00 a.m., California time, on the first

full business day following the effectiveness of the Registration Statement, or (ii) if at the time of execution of this Agreement the Registration Statement has been declared effective, at 6:00 a.m., California time, on the first full business day following the date of execution of this Agreement; but this Agreement shall nevertheless become effective at such earlier time after the Registration Statement becomes effective as you may determine on and by notice to the Company or by release of any of the Common Shares for sale to the public. For the purposes of this Section 12, the Common Shares shall be deemed to

have been so released upon the release for publication of any newspaper advertisement relating to the Common Shares or upon the release by you of notices (i) advising Underwriters that the Common Shares are released for public offering, or (ii) offering the Common Shares for sale to securities dealers, whichever may occur first.

SECTION 13. Termination. Without limiting the right to terminate this Agreement pursuant to any other provision hereof:

(a) This Agreement (except for the expenses to be paid by the Company pursuant to Section 6 hereof and except to the extent provided in Section 10 hereof) may be terminated by the Representative by notice to the Company and the Attorney-in-Fact in the event that the Company or any of the Selling Shareholders has failed to comply in any respect with any of the provisions of this Agreement required on its part to be performed at or prior to the First Closing Date or the Second Closing Date, as the case may be, or if any of the representations or warranties of the Company or any of the Selling Shareholders is not accurate in any respect or if the covenants, agreements or conditions of, or applicable to, the Company or any of the Selling Shareholders herein contained have not been complied with in any respect or satisfied within the time specified on the First Closing Date or the Second Closing Date, respectively.

(b) This Agreement also may be terminated by the Representatives prior to the First Closing Date by notice to the Company and the Attorney-in-Fact (i) if material governmental restrictions, not in force and effect on the date hereof, shall have been imposed upon trading in securities generally or minimum or maximum prices shall have been generally established on the New York Stock Exchange or on the American Stock Exchange or in the over the counter market by the NASD, or trading in securities generally shall have been suspended on either such Exchange or in the over the counter market by the NASD, or a general banking moratorium shall have been established by federal, New York or California authorities, (ii) if an outbreak of major hostilities or other national or international calamity or any substantial change in political, financial or economic conditions shall have occurred or shall have accelerated or escalated to such an extent, as, in the reasonable judgment of the Representatives, to affect materially and adversely the marketability of the Common Shares, (iii) if any adverse event shall have occurred or shall exist which makes untrue or incorrect in any material respect any statement or information contained in the Registration Statement

or the Prospectus or any amendment thereof or which is not reflected in the Registration Statement or the Prospectus but should be reflected therein in order to make the statements or information contained therein not misleading in any material respect, (iv) if, on or after the date hereof, there shall be any action, suit or proceeding pending or threatened, or there shall have been any development or prospective development involving particularly the business or properties or securities of the

Company or any of the Banks or the transactions contemplated by this Agreement, which, in the reasonable judgment of the Representatives, may materially and adversely affect the Company's or either of the Bank's business or earnings and makes it impracticable or inadvisable to offer or sell the Common Shares; or (v) the Company or either of the Banks shall have sustained a loss by strike, fire, flood, earthquake, accident or other calamity of such a character as to interfere materially with the conduct of the business and operations of the Company or either of the Banks regardless of whether or not such loss was insured. Any termination pursuant to this Section 13(b) shall be without liability on the part of any Underwriter to the Company or on the part of the Company to you or any Underwriter (except for expenses to be paid or reimbursed by the Company pursuant to Sections 6 and 8 hereof and except to the extent provided in Section 10 hereof).

SECTION 14. Representations and Indemnities to Survive Delivery. The respective indemnities, agreements, representations, warranties and other statements of the Company, the Selling Shareholders, its officers and the several Underwriters set forth in or made pursuant to this Agreement will remain in full force and effect, regardless of any investigation made by or on behalf of any Underwriter, the Selling Shareholders or the Company, or any of its or their partners, officers or directors or any controlling persons, as the case may be, and will survive delivery of and payment for the Common Shares sold hereunder. Any successors to the Underwriters shall be entitled to the indemnity, contribution and reimbursement agreements contained in this Agreement.

SECTION 15. Substitution of Underwriters. If one or more of the Underwriters shall fail or refuse (otherwise than for a reason sufficient to justify the termination of this Agreement under the provisions of Section 7 or 13 hereof) to purchase and pay for (a) in the case of the First Closing Date, the number of Firm Common Shares agreed to be purchased by such Underwriter or Underwriters upon tender to you of such Firm Common Shares in accordance with the terms hereof or (b) in the case of the Second Closing Date, the number of Optional Common Shares agreed to be purchased by such Underwriter or Underwriters upon tender to you of such Optional Common Shares in accordance with the terms hereof, and the number of such shall not exceed 10% of the Firm Common Shares or Optional Common Shares required to be purchased on the First Closing Date or the Second Closing Date, as the case may be, then, each of the non-defaulting Underwriters shall purchase and pay for (in addition to the number of such Shares which it has severally agreed to purchase hereunder) that proportion of the number of Shares which the

defaulting Underwriter or Underwriters shall have so failed or refused to purchase on such First Closing Date or Second Closing Date, as the case may be, which the number of Firm Common Shares agreed to be purchased by such non-defaulting Underwriter bears to the aggregate number of Common Shares so agreed to be purchased by all such non-defaulting Underwriters on such First Closing Date or Second Closing Date, as the case may be.

In such case, you shall have the right to postpone the First Closing Date or the Second Closing Date, as the case may be, to a date not exceeding seven full business days after the date originally fixed as such First Closing Date or Second Closing Date, as the case may be, pursuant to the terms hereof in order that any necessary changes in the Registration Statement, the Prospectus or any other documents or arrangements may be made.

If one or more of the Underwriters shall fail or refuse (otherwise than for a reason sufficient to justify the termination of this Agreement under the provisions of Section 7 or 13 hereof) to purchase and pay for (a) in the case of the First Closing Date, the number of Firm Common Shares agreed to be purchased by such Underwriter or Underwriters upon tender to you of such Firm Common Shares in accordance with the terms hereof or (b) in the case of the Second Closing Date, the number of Optional Common Shares agreed to be purchased by such Underwriter or Underwriters upon tender to you of such Optional Common Shares in accordance with the terms hereof, and the number of such Shares shall exceed 10% of the Firm Common Shares or Optional Common Shares required to be purchased by all the Underwriters on the First Closing Date or the Second Closing Date, as the case may be, then (unless within 48 hours after such default arrangements to your satisfaction shall have been made for the purchase of the defaulted Shares by an Underwriter or Underwriters) and subject to the provisions of Section 13 hereof, this Agreement will terminate without liability on the part of any non-defaulting Underwriter or on the part of the Company except as otherwise provided hereof. As used in this Agreement, the term "Underwriter" includes any person substituted for an Underwriter under this paragraph. Nothing in this Section 12, and no action taken hereunder, shall relieve any defaulting Underwriter from liability in respect of any default of such Underwriter under this Agreement.

SECTION 16. Notices. All communications hereunder shall be in writing and, if sent to the Underwriters, shall be mailed, delivered or telecopied and confirmed to you at 1150 Santa Monica Boulevard, Suite 1500, Los Angeles, California 90025, with a copy to Manatt, Phelps & Phillips, LLP, 11355 W. Olympic Blvd., Los Angeles, California 90064, Attention: Paul H. Irving, Esq., FAX: (310) 312-4224; if sent to the Company or the Selling Shareholders, shall be mailed, delivered or telecopied and confirmed to the Company at 23332 Mill Creek Drive, Suite 2309, Laguna Hills, California 92653, with a copy to Morrison & Foerster, 19990 MacArthur Boulevard, Suite 1200, Irvine, California 92612-2445, Attention: Ellen Marshall, The Company or you may change the address for receipt of communications hereunder by giving notice to the others.

SECTION 17. Successors. This Agreement will inure to the benefit of



and be binding upon the Company, the Selling Shareholders and each Underwriter, including any substitute Underwriters pursuant to Section 15 hereof, and to the benefit

of the officers and directors and controlling persons referred to in Section 10 hereof, and in each case their respective successors, personal representatives and assigns, and no other person will have any right or obligation hereunder. No such assignment shall relieve any party of its obligations hereunder. The term "successors" shall not include any purchaser of the Common Shares as such from any of the Underwriters merely by reason of such purchase.

SECTION 18. Representation of Underwriters. You will act as Representatives for the several Underwriters in connection with all dealings hereunder, and any action under or in respect of this Agreement taken by you, as Representatives, will be binding upon all the Underwriters.

SECTION 19. Partial Unenforceability. The invalidity or unenforceability of any Section, paragraph or provision of this Agreement shall not affect the validity or enforceability of any other Section, paragraph or provision hereof. If any Section, paragraph or provision of this Agreement is for any reason determined to be invalid or unenforceable, there shall be deemed to be made such minor changes (and only such minor changes) as are necessary to make it valid and enforceable.

SECTION 20. Applicable Law. This Agreement shall be governed by and construed in accordance with the internal laws (and not the laws pertaining to conflicts of laws) of the State of California.

SECTION 21. General. This Agreement constitutes the entire agreement of the parties to this Agreement and supersedes all prior written or oral and all contemporaneous oral agreements, understandings and negotiations with respect to the subject matter hereof. This Agreement may be executed in several counterparts, each one of which shall be an original, and all of which shall constitute one and the same document.

In this Agreement, the masculine, feminine and neuter genders and the singular and the plural include one another. The Section headings in this Agreement are for the convenience of the parties only and will not affect the construction or interpretation of this Agreement. This Agreement may be amended or modified, and the observance of any term of this Agreement may be waived, only by a writing signed by the Company and you.

If the foregoing is in accordance with your understanding of our agreement, kindly sign and return to us the enclosed copies hereof, whereupon it will become a binding agreement between the Company and you, all in accordance with its terms.

Very truly yours,

PACIFIC COMMUNITY BANKING GROUP

By: \_\_\_\_\_  
Chief Executive Officer

SELLING SHAREHOLDERS FROM BANK OF  
HEMET AS LISTED ON SCHEDULE B

By: \_\_\_\_\_  
As Attorney-in-Fact for the Selling  
Shareholders identified in Schedule B  
Shareholders from Bank of Hemet

SELLING SHAREHOLDERS FROM VALLEY BANK AS  
LISTED ON SCHEDULE B

By: \_\_\_\_\_  
As Attorney-in-Fact for the Selling  
Shareholders identified in Schedule B  
Shareholders from Valley Bank

John Brudin

By: \_\_\_\_\_  
John Brudin

Jack E. Gosch

By: \_\_\_\_\_  
Jack E. Gosch

E. Kenneth Hyatt

By: \_\_\_\_\_  
E. Kenneth Hyatt

James B. Jaqua

By: \_\_\_\_\_  
James B. Jaqua

John J. McDonough

By: \_\_\_\_\_  
John J. McDonough

Joseph D. Pehl

By: \_\_\_\_\_  
Joseph D. Pehl

Clayton A. Record, Jr.

By: \_\_\_\_\_  
Clayton A. Record, Jr.

Harold R. Williams, Jr.

By: \_\_\_\_\_  
Harold R. Williams, Jr.

Robert I. Robie

By: \_\_\_\_\_  
Robert I. Robie

Marion V. Ashley

By: \_\_\_\_\_  
Marion V. Ashley

Willow I. Decker

By: \_\_\_\_\_  
Willow I. Decker

Juan P. Renteria

By: \_\_\_\_\_  
Juan P. Renteria

Jesse Washington

By: \_\_\_\_\_  
Jesse Washington

George E. Wilson

By: \_\_\_\_\_  
George E. Wilson

Helga Wolf

By: \_\_\_\_\_  
Helga Wolf

Eugene H. Wood

By: \_\_\_\_\_  
Eugene H. Wood

N. Douglas Mills

By: \_\_\_\_\_  
N. Douglas Mills

Valley Bank Employee Stock Ownership Plan

By: \_\_\_\_\_  
Eri Hook - Joint Trustee

By: \_\_\_\_\_  
N. Douglas Mills- Joint Trustee

By: \_\_\_\_\_  
Mark Nugent - Joint Trustee

By: \_\_\_\_\_  
Dianna Williams - Joint Trustee

By: \_\_\_\_\_  
George E. Wilson - Joint Trustee

Mark Nugent

By: \_\_\_\_\_  
Mark Nugent

Kenneth Ray

By: \_\_\_\_\_  
\_\_\_\_\_,  
as Conservator for Kenneth Ray

Dianna Williams

By: \_\_\_\_\_  
Dianna Williams

Charles L. Motte and Ottie Mae Motte Trust of  
4/29/75

By: \_\_\_\_\_  
Charles L. Motte and Ottie Mae Motte as  
Trustees

THE BANK OF HEMET

By: \_\_\_\_\_  
James B. Jaqua  
President and Chief Executive Officer

VALLEY BANK

By: \_\_\_\_\_  
N. Douglas Mills  
President and Chief Executive Officer

By: \_\_\_\_\_  
Marion V. Ashley  
Chairman of the Board

The foregoing Underwriting Agreement is hereby confirmed and accepted by Sutro & Co. Incorporated, Friedman, Billings, Ramsey & Co., Inc., Wedbush Morgan Securities, Inc. and Ragen MacKenzie Incorporated in Los Angeles, California as of the date first above written.

SUTRO & CO. INCORPORATED  
As Representative of the several Underwriters

By Sutro & Co. Incorporated

By: \_\_\_\_\_

Its: \_\_\_\_\_

SCHEDULE A

SCHEDULE OF UNDERWRITERS

<TABLE>  
<CAPTION>

NAME OF UNDERWRITER

NUMBER OF FIRM  
COMMON  
SHARES  
TO BE  
PURCHASED

<S>

<C>

Sutro & Co. Incorporated

Friedman, Billings, Ramsey & Co., Inc.

Wedbush Morgan Securities, Inc.

Ragen MacKenzie Incorporated

[NAMES OF OTHER UNDERWRITERS]

Total

</TABLE>

SCHEDULE B

SCHEDULE OF SELLING SHAREHOLDERS

<TABLE>

<CAPTION>

NAME AND ADDRESS OF SELLING SHAREHOLDER

FIRM SHARES TO BE SOLD

<S>

<C>

HEMET MAJOR SELLING SHAREHOLDERS

1. John Brudin  
[Address]
2. Jack E. Gosch  
[Address]
3. E. Kenneth Hyatt  
[Address]
4. James B. Jaqua  
[Address]
5. John J. McDonough  
[Address]
6. Joseph D. Pehl  
[Address]
7. Clayton A. Record, Jr.  
[Address]
8. Harold R. Williams, Jr.

[Address]

9. Robert I. Robie

[Address]

VALLEY MAJOR SELLING SHAREHOLDERS

1. Marion V. Ashley

[Address]

2. Willow I. Decker

[Address]

3. Juan P. Renteria

[Address]

4. Jesse Washington

[Address]

5. George E. Wilson

[Address]

6. Helga Wolf

[Address]

7. Eugene H. Wood

[Address]

8. N. Douglas Mills

[Address]

9. Valley Bank Employee Stock Ownership Plan

[Address]

10. Mark Nugent

[Address]

11. Kenneth Ray

[Address]

12. Dianna Williams

[Address]

13. Charles L. Motte and Ottie Mae Motte Trust  
of 4/29/75

[Address]

[OTHER SELLING SHAREHOLDERS

[List of all other Hemet Selling Shareholders]

[List of all other Valley Selling Shareholders]]

</TABLE>

July 27, 1999

Pacific Community Banking Group  
23332 Mill Creek Drive, Suite 230  
Laguna Hills, California 92653

Re: Registration Statement on Form S-1 (File No. 333-76403)

Ladies and Gentlemen:

At your request, we have examined the Registration Statement on Form S-1, as amended, filed under the Securities Act of 1933, as amended (the "Securities Act"), by Pacific Community Banking Group, a California corporation (the "Company"), with the Securities and Exchange Commission relating to the registration under the Securities Act of 4,305,000 shares of the Company's common stock (the "Shares"). The Registration Statement includes (i) up to 1,276,430 authorized but unissued shares being offered by the Company and (ii) 3,028,570 shares being offered by shareholders of the Company (the "Selling Shareholders"). The Selling Shareholders will sell their Shares upon the exchange of shares of Valley Bank and The Bank of Hemet (each a California corporation) held by them for shares of Pacific Community Banking Group, pursuant to a First Restatement of Agreement and Plan of Reorganization between The Bank of Hemet and the Company, dated January 5, 1999, as amended, and a First Restatement of Agreement and Plan of Reorganization between Valley Bank and the Company dated January 5, 1999, as amended (collectively, the "Acquisition Agreements"). The Shares will be sold to certain underwriters for resale to the public.

As counsel to the Company, we have examined the proceedings taken and proposed to be taken by the Company in connection with the proposed issuance and sale by the Company of the Shares and the sale of Shares by the Selling Shareholder. We have examined the Registration Statement. We have also examined the Acquisition Agreements.

We are of the opinion that (a) the Shares to be offered and sold by the Company have been duly authorized and, when issued and sold by the Company in the manner described in the Registration Statement and in accordance with the resolutions adopted by the Board of Directors of the Company, will be validly issued, fully paid and nonassessable, and (b) the Shares to be offered and sold by the Selling Shareholders have been duly authorized and, upon the surrender of the shares of The Bank of Hemet and Valley Bank in exchange therefor in accordance with the Acquisition Agreements, will be validly issued, fully paid and nonassessable.



Pacific Community Banking Group

July 27, 1999

Page 2

We consent to the use of this opinion as an exhibit to the Registration Statement.

Very truly yours,

/s/ Morrison & Foerster LLP

## AGREEMENT

This AGREEMENT is entered into this 24th day of March, 1999, amended July 28, 1999 by and between THE BANK OF HEMET, a California corporation (hereinafter referred to as the "Bank"), PACIFIC COMMUNITY BANKING GROUP, a California corporation (hereinafter referred to as the "Company"), and HAROLD R. WILLIAMS, JR. (hereinafter referred to as the "Executive"). This Agreement will become effective upon the completion of the acquisition of the Bank by the Company pursuant to the First Restatement of Agreement and Plan of Reorganization dated January 5, 1999, as amended.

## RECITALS

WHEREAS, Executive has been an Executive Officer of the Bank since 1994 and will become Executive Vice President and Chief Financial Officer of the Company upon the completion of the acquisition of the Bank by the Company;

WHEREAS, the Bank and the Company desire to continue to avail itself of the skill, knowledge and experience of Executive in order to ensure the successful operation of the Bank and the Company without distraction; and

WHEREAS, to induce Executive to remain in the employ of the Bank and the Company, and to continue as an Executive Officer of the Bank, to become Interim Chief Executive Officer of the Bank, and to become Executive Vice President and Chief Financial Officer of the Company, the Bank and the Company are willing to provide benefits to Executive in the event his employment is terminated or adversely affected as provided herein.

NOW, THEREFORE, in consideration of the mutual covenants and conditions hereinafter set forth, the parties hereto covenant and agree as follows:

### A. TERM OF AGREEMENT

This Agreement shall terminate upon the first to occur of (i) the termination of Executive's employment with Bank and/or the Company for Cause, Disability (both as defined below), death of Executive, or voluntarily by Executive other than for Good Reason, and shall have occurred between the effective date of this Agreement and December 31, 2002 (the "Term of this Agreement"), or (ii) December 31, 2002.

### B. EFFECT ON EMPLOYMENT

-1-

This Agreement is not intended to alter or otherwise change the current employment relationship between Executive and the Bank and/or the Company except

as described in the following Paragraphs, and Executive further acknowledges his employment at-will status with the Bank and the Company as described under the Bank's Personnel Policy.

C. TERMINATION OF EMPLOYMENT

If Executive's employment is terminated by the Bank and the Company, or Executive terminates employment with the Bank and/or the Company pursuant to Paragraph C.3. below, and unless such termination is (a) because of his death, (b) for Cause or Disability (both as defined below) or (c) by Executive other than for Good Reason (as defined below), he shall be entitled to the benefits provided in Paragraph D.2(a). or D.2(b). below.

1. DISABILITY. If, as a result of Executive's incapacity due to physical or mental illness, he shall have been absent from or unable to perform his duties with the Bank and/or the Company for a period of three consecutive months, and if within 30 days after written notice of termination is given (which notice may not be given prior to the expiration of the three-month period) he shall not have recommenced the full-time performance of his duties, the Bank and/or the Company may terminate his employment for "Disability."

2. CAUSE. Termination of Executive's employment for "Cause" shall mean the determination by the Bank and/or the Company that the Executive has (i) willfully failed to perform or habitually neglected the appropriate duties which he is required to perform hereunder; or (ii) willfully failed to follow any significant policy of the Company which materially or adversely affects the condition of the Company; or (iii) engaged in any activity in contravention of any significant company policy, statute, regulation or governmental policy which materially or adversely affects the Company's condition; or (iv) willfully refused to follow any lawful and appropriate instruction from the Board of Directors unless Executive asserts that compliance with such instruction would cause the Company or Executive to violate any statute, regulation, governmental or Company policy; or (v) subject to Section C.1 above, become physically or mentally disabled and evidences his inability to discharge his duties as Chief Financial Officer of the Company; or (vi) been convicted of or pleaded guilty or nolo contendere to any felony; or (vii) committed any act which would cause termination of coverage under the Company's Bond as to Executive, as distinguished from termination of coverage as to the Company as a whole. For purposes of this Agreement, "Cause" shall also mean the Company is required to remove or replace Executive by formal order or instruction, including a consent order or agreement, from the California Department of Financial Institutions, the Federal Reserve Bank, or any other

-2-

supervisory authority having jurisdiction.

-3-

3. GOOD REASON. Termination by Executive of his employment for "Good Reason" shall mean termination by him after any of the following events occur without his express written consent:

(i) A reduction in Executive's then current annual salary or benefits;

(ii) A material diminution in Executive's title, authority or responsibilities;

4. NOTICE OF TERMINATION. Any purported termination by the Bank and/or the Company, or by Executive for Good Reason, shall be communicated by written "Notice of Termination" to the other party hereto. A Notice of Termination shall mean a notice which indicates the specific termination provision in this Agreement relied upon and sets forth in reasonable detail the facts and circumstances claimed to provide a basis for termination of Executive's employment under the provision so indicated.

5. DATE OF TERMINATION. The "Date of Termination" shall mean (i) if Executive's employment is terminated by death, the date of death, (ii) if Executive's employment is terminated for Disability, 30 days after Notice of Termination is given (provided that Executive shall not have recommenced the full-time performance of his duties during such 30-day period), (iii) if Executive's employment is terminated pursuant to subparagraph 2 or 3 above, the date specified in the Notice of Termination, which shall be not less than 30 days after the date such Notice of Termination is given, and (iv) if Executive voluntarily terminates employment for other than for Good Reason, the date specified in the Notice of Termination, which shall be not less than 30 days after the Notice of Termination is given.

#### D. BENEFITS

1. REGULAR COMPENSATION. If Executive's employment shall be terminated by the Bank and/or the Company for Disability, Cause, or his death, or by Executive other than for Good Reason, the Bank and/or the Company shall pay Executive the full accrued base salary and accrued incentive bonus through the Date of Termination, less withholding required by law, at the rate in effect at the time Notice of Termination is given or death occurs, and the Bank and the Company shall have no further obligation to him under this Agreement.

2. SEVERANCE BENEFITS. (a) If Executive's employment shall be terminated by the Bank and/or the Company other than for Disability, Cause or his death, or by Executive for Good Reason, within twelve (12) months of the effective date of this Agreement, Executive shall be entitled to receive an

amount equal to Executive's base salary paid by the Bank and/or the Company to

Executive for the previous eighteen (18) months. Such amount shall be payable to Executive in a lump sum payment within three (3) business days following the Date of Termination, less withholding as required by law. In addition, the Bank and/or the Company shall continue payment of all of Executive's benefits in effect on the date of Executive's termination including health and other medical benefits for a period of eighteen (18) months from the Date of Termination. Payment of the foregoing amounts shall discharge the Bank and the Company from any further obligation and liability to Executive under this Agreement.

(b) If Executive's employment shall be terminated by the Bank and/or the Company other than for Disability, Cause or his death, or by Executive for Good Reason, after twelve (12) months from the effective date of this Agreement until December 31, 2002, Executive shall be entitled to receive an amount equal to Executive's base salary paid by the Bank and/or the Company to Executive for the previous twelve (12) months. Such amount shall be payable to Executive in a lump sum payment within three (3) business days following the Date of Termination, less withholding as required by law. In addition, the Bank and/or the Company shall continue payment of all of Executive's benefits in effect on the date of Executive's termination including health and other medical benefits for a period of twelve (12) months from the Date of Termination. Payment of the foregoing amounts shall discharge the Bank and the Company from any further obligation and liability to Executive under this Agreement.

Notwithstanding the foregoing, in the event that any payment or benefit received or to be received by Executive in connection with the termination of employment pursuant to the terms of this Agreement would not be deductible (in whole or in part) by the Bank and/or the Company as a result of Section 280G of the Internal Revenue Code of 1986, as amended (the "Code"), the amount of the payment shall be reduced until no portion is not deductible as a result of Section 280G of the Code.

3. BONUS. Executive shall be entitled to a bonus in the minimum amount of \$60,000 which shall be payable no later than February 29, 2000. In addition, during the term of this Agreement, Executive may receive such bonuses, if any, as the Board of Directors in its sole discretion shall determine.

4. STOCK OPTIONS. Upon the completion of the acquisition of the Bank by the Company, Executive shall be granted a ten-year incentive stock option of 50,000 option shares under the Company's 1999 Stock Option Plan at an exercise price equal to the Company's initial public offering price. Such stock options shall be vested immediately, but be exercisable starting after one

-5-

year from the date granted in an amount not to exceed 20% per year for the first five (5) years.

E. GENERAL PROVISIONS

1. RETURN OF DOCUMENTS. Executive expressly agrees that all manuals, documents, files, reports, studies, instruments or other materials used and/or developed by Executive related to banking or of a banking nature during the term of his employment are solely the property of the Bank and/or the Company, and that Executive has no right, title or interest therein. Upon termination of Executive's employment, Executive shall promptly deliver possession of all of said property to the Bank and/or the Company in good condition.

2. NOTICES. Any notice, request, demand or other communication required or permitted hereunder shall be in writing and shall be deemed to be properly given when personally served or forty-eight hours after deposit in the United States mail, postage prepaid, in each case addressed to the Bank and/or the Company as its head office location or to Executive at his last residence address on the Bank or the Company's records. Either party may change its address by written notice in accordance with this subparagraph.

3. BINDING EFFECT; SUCCESSORS. Except to the extent otherwise provided herein, this Agreement shall inure to the benefit of and be binding upon the parties hereto and their respective executors, administrators, successors and assigns. The Bank and/or the Company will require any successor to all or substantially all of its assets to expressly assume and agree to perform this Agreement in the same manner and to the same extent that the Bank and/or the Company would be required to perform it if no such succession had taken place. Failure of the Bank and/or the Company to obtain such assumption and agreement prior to the effectiveness of any such succession shall entitle Executive to the benefits from the Bank and/or the Company in the same amount and on the same terms as he would be entitled to hereunder if he terminated his employment for Good Reason, except that for purposes of implementing the foregoing, the date on which any such succession becomes effective shall be deemed the Date of Termination.

4. APPLICABLE LAW. Except to the extent governed by the laws of the United States, this Agreement is to be governed by and construed under the laws of the State of California.

5. CAPTIONS AND PARAGRAPH HEADINGS. Captions and paragraph headings used herein are for convenience only and are not part of this Agreement and shall not be used in construing it.

-6-

6. SEVERABILITY. Should any provision of this Agreement for any reason be declared invalid, void or unenforceable by a court of competent jurisdiction, the validly and binding effect of any remaining portion shall not be affected, and the remaining portions of this Agreement shall remain in full force and effect as if this Agreement had been executed with said provision eliminated.

7. ENTIRE AGREEMENT. This Agreement contains the entire agreement of the parties relating to termination of employment as provided herein. It supersedes any and all other agreements, either oral or in writing, between the parties hereto with respect to such subject matter, and does not otherwise modify, alter or change the employment relationship of Executive with the Bank and/or the Company. Each party to this Agreement acknowledges that no representations, inducements, promises or agreements, oral or otherwise, have been made by any party, or anyone acting on behalf of any party, which are not embodied herein, and that no other agreement, statement or promise not contained in this Agreement concerning its subject matter shall be valid or binding.

8. MODIFICATION; WAIVER. No provision of this Agreement may be modified, waived or discharged unless such modification, waiver or discharge is agreed to in writing and signed by Executive and such officer of the Bank and/or the Company as may be specifically designated or authorized by the Board of Directors or by the Chief Executive Officer. No waiver by either party hereto at any time of any breach by the other party hereto of, or compliance with, any condition or provision of this Agreement to be performed by such other party shall be deemed a waiver of similar or dissimilar provisions or conditions at the same or at any prior or subsequent time.

9. ARBITRATION. In the event that any dispute shall arise between the parties concerning the provisions of this Agreement or the performance of any part of their obligations hereunder, or in the event of an alleged breach of this Agreement by either of the parties hereto, and the parties are unable to mutually adjust and settle same, such dispute or disputes shall be submitted to binding arbitration pursuant to the applicable rules of the American Arbitration Association, and the decision and determination of the arbitrators shall be final and conclusive.

-7-

IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of the day and year first above written.

THE BANK OF HEMET

By: \_\_\_\_\_  
James B. Jaqua, President and  
Chief Executive Officer

By: \_\_\_\_\_  
Leslie Basic, Assistant Secretary

By: \_\_\_\_\_  
E. Lynn Caswell, Chairman of the Board

By: \_\_\_\_\_  
Alfred Jannard, Secretary

EXECUTIVE

-----  
Harold R. Williams, Jr.



PACIFIC COMMUNITY BANKING GROUP

1999 STOCK OPTION PLAN

Adopted February 23, 1999

Amended July 27, 1999

1. PURPOSE

The purpose of the Pacific Community Banking Group 1999 Stock Option Plan (the "Plan") is to strengthen Pacific Community Banking Group (the "Corporation") and those corporations which are or hereafter become subsidiary corporations by providing additional means of attracting and retaining competent managerial personnel and by providing to participating directors, officers, key employees, consultants and others with significant and material business relationships added incentives for high levels of performance and for unusual efforts to increase the earnings of the Corporation and any Subsidiary corporations; and to allow such individuals the opportunity to participate in the ownership of the Corporation and thereby have an interest in the success and increased value of the Corporation. The Plan seeks to accomplish these purposes and achieve these results by providing a means whereby such directors, officers, key employees, consultants and others with significant and material business relationships may purchase shares of Common Stock of the Corporation pursuant to Stock Options granted in accordance with this Plan.

1

Stock Options granted pursuant to this Plan are intended to be Incentive Stock Options or Non-Qualified Stock Options, as shall be determined and designated by the Stock Option Committee upon the grant of each Stock Option hereunder.

2. DEFINITIONS

For the purposes of this Plan, the following terms shall have the following meanings:

(a) "COMMON STOCK." This term shall mean shares of the Corporation's no par value common stock, subject to adjustment pursuant to Paragraph 14 (Adjustment Upon Changes in Capitalization) hereunder.

(b) "CORPORATION." This term shall mean Pacific Community Banking Group, a California corporation.

(c) "ELIGIBLE PARTICIPANT." This term shall mean: (i) all

directors of the Corporation or any Subsidiary; (ii) all full time officers (whether or not they are also directors) of the Corporation or any Subsidiary; (iii) all full time key employees (as such persons may be determined by the Stock Option Committee from time to time) of the Corporation or any Subsidiary; and (iv) consultants and others with significant and material business relationships with the Corporation.

(d) "EMPLOYER." This term shall mean the Corporation, as defined herein, or any other subsidiary of the Corporation, as appropriate, depending upon which company Optionee is employed.

2

(e) "FAIR MARKET VALUE." This term shall mean the fair market value of the Corporation's Common Stock as determined by any reasonable valuation method in accordance with the Commissioner of Corporations Regulation Section 260.140.50, which generally provides that in determining whether the price is fair, predominant weight will be given to the following: (a) if securities of the same class are publicly traded on an active market of substantial depth, the recent market price of such securities; (b) if the securities of the same class have not been so publicly traded, the price at which securities of reasonable comparable corporations (if any) in the same industry are being traded, subject to appropriate adjustments for the dissimilarities between the corporations being compared; or (c) in the absence of any reliable indicator under subsection (a) or (b), the earnings history, book value and prospects of the issuer in light of market conditions generally.

(f) "INCENTIVE STOCK OPTION." This term shall mean a Stock Option which is an "Incentive Stock Option" within the meaning of Section 422A of the Internal Revenue Code of 1986, as amended.

(g) "NON-QUALIFIED STOCK OPTION." This term shall mean a Stock Option which is not an Incentive Stock Option.

(h) "OPTION SHARES." This term shall mean shares of Common Stock which are covered by and subject to any outstanding unexercised Stock Option granted pursuant to this Plan.

3

(i) "OPTIONEE." This term shall mean any Eligible Participant to whom a stock option has been granted pursuant to this Plan, provided that at least part of the Stock Option is outstanding and unexercised.

(j) "PLAN." This term shall mean the Pacific Community Banking Group 1999 Stock Option Plan as embodied herein and as may be amended

from time to time in accordance with the terms hereof and applicable law.

(k) "STOCK OPTION." This term shall mean the right to purchase from the Corporation a specified number of shares of Common Stock under the Plan at a price and upon terms and conditions determined by the Stock Option Committee.

(l) "STOCK OPTION COMMITTEE." The Board of Directors of the Corporation may select and designate a stock option committee consisting of at least three and not more than five persons, at least two of whom are directors, having full authority to act in the matters. Regardless of whether a Stock Option Committee is selected, the Board of Directors may act as the Stock Option Committee and any action taken by the Board of Directors as such shall be deemed to be action taken by the Stock Option Committee. All references in the Plan to the "Stock Option Committee" shall be deemed references to the Board of Directors acting as a stock option committee and to a duly appointed Stock Option Committee, if there be one. In the event of any conflict between any action taken by the Board of Directors acting as a Stock Option Committee and any action taken by a duly appointed Stock Option Committee, the action taken

4

by the Board of Directors shall be controlling and the action taken by the duly appointed Stock Option Committee shall be disregarded.

(m) "SUBSIDIARY." This term shall mean any subsidiary corporation of the Corporation as such term is defined in Section 425(f) of the Internal Revenue Code of 1986, as amended.

### 3. ADMINISTRATION

(a) STOCK OPTION COMMITTEE. This Plan shall be administered by the Stock Option Committee. The Board of Directors of the Corporation shall have the right, in its sole and absolute discretion, to remove or replace any person from or on the Stock Option Committee at any time for any reason whatsoever.

(b) ADMINISTRATION OF THE PLAN. Any action of the Stock Option Committee with respect to the administration of the Plan shall be taken pursuant to a majority vote, or pursuant to the unanimous written consent, of its members. Any such action taken by the Stock Option Committee in the administration of this Plan shall be valid and binding, so long as the same is in conformity with the terms and conditions of this Plan. Subject to compliance with each of the terms, conditions and restrictions set forth in this Plan, including, but not limited to, those set forth in Section 6(a)(ii) hereof, the Stock Option Committee shall have the exclusive right, in its sole and absolute discretion, to establish the terms and conditions of any Stock Options granted under the Plan, including, without limitation, the

power to: (i) establish the number of Stock Options, if any, to be granted hereunder, in the aggregate and with regard to any individual Eligible

5

Participant; (ii) determine the time or times when such Stock Options, or any parts thereof, may be vested and exercised; (iii) determine and designate which Stock Options granted under the Plan shall be Incentive Stock Options and which shall be Non-Qualified Stock Options; (iv) determine the Eligible Participants, if any, to whom Stock Options are granted; (v) determine the duration and purposes, if any, of leaves of absence which may be permitted to holders of unexercised, unexpired Stock Options without such constituting a termination of employment under the Plan; (vi) prescribe and amend the terms, provisions and form of any instrument or agreement setting forth the terms and conditions of every Stock Option granted hereunder; and (vii) make loans to or guarantee any obligations of any Optionees, except directors, in connection with the exercise of Stock Options as specified in Section 8(d) hereof, whenever the Stock Option Committee determines that such loan or guarantee may reasonably be expected to benefit the corporation, subject to the provisions of Section 315(b) of the California General Corporations Law of 1977, as amended and subject to Regulations G, U and T promulgated by the Board of Governors of the Federal Reserve System pursuant to Section 7 of the Securities Exchange Act of 1934, if the Option Shares are listed on a stock exchange or are contained in the list of over-the-counter margin securities published by the Federal Reserve Board.

(c) DECISIONS AND DETERMINATIONS. Subject to the express provisions of the Plan, the Stock Option Committee shall have the authority to construe and interpret the Plan, to define the terms used therein, to prescribe, amend, and

6

rescind rules and regulations relating to the administration of the Plan, and to make all other determinations necessary or advisable for administration of the Plan. Determinations of the Stock Option Committee on matters referred to in this Section 3 shall be final and conclusive so long as the same are in conformity with the terms of this Plan.

#### 4. SHARES SUBJECT TO THE PLAN

Subject to adjustments as provided in Section 14 hereof, the maximum number of shares of Common Stock which may be issued upon exercise of Stock Options granted under this Plan is limited to 30% of the issued and outstanding shares of the Corporation up to a maximum of [1,350,000] shares in the aggregate. If any Stock Option shall be canceled, surrendered, or expire for any reason without having been exercised in full, the unpurchased Option Shares represented thereby shall again be available for grants of

Stock Options under this Plan.

5. ELIGIBILITY

Only Eligible Participants shall be eligible to receive grants of Stock Options under this Plan.

6. GRANTS OF STOCK OPTIONS

(a) GRANT. Subject to the express provisions and limitations of the Plan, the Stock Option Committee, in its sole and absolute discretion, may grant Stock Options to Eligible Participants of the Corporation, for a number of Option Shares, at the price(s) and time(s), on the terms and conditions and to such Eligible Participants as it deems advisable and specifies in the respective grants.

7

Subject to the limitations and restrictions set forth in the Plan, an Eligible Participant who has been granted a Stock Option may, if otherwise eligible, be granted additional Stock Options if the Stock Option Committee shall so determine. The Stock Option Committee shall designate in each grant of a Stock Option whether the Stock Option is an Incentive Stock Option or a Non-Qualified Stock Option.

An eligible director, officer or employee shall not participate in the granting of his or her own options.

(b) DATE OF GRANT AND RIGHTS OF OPTIONEE. The determination of the Stock Option Committee to grant a Stock Option shall not in any way constitute or be deemed to constitute an obligation of the Corporation, or a right of the Eligible Participant who is the proposed subject of the grant, and shall not constitute or be deemed to constitute the grant of a Stock Option hereunder unless and until both the Corporation and the Eligible Participant have executed and delivered the form of stock option agreement then required by the Stock Option Committee as evidencing the grant of the Stock Option, together with such other instruments as may be required by the Stock Option Committee pursuant to this Plan; provided, however, that the Stock Option Committee may fix the date of grant as any date on or after the date of its final determination to grant the Stock Option (or if no such date is fixed, then the date of grant shall be the date on which the determination was finally made by the Stock Option Committee to grant the Stock Option), and such date shall be set forth in the stock option agreement. The date

8

of grant as so determined shall be deemed the date of grant of the Stock Option for purposes of this Plan.

(c) SHAREHOLDER-EMPLOYEES. Notwithstanding anything to the contrary contained elsewhere herein, a Stock Option shall not be granted hereunder to an Eligible Participant who owns, directly or indirectly, at the date of the grant of the Stock Option, more than ten percent (10%) of the total combined voting power of all classes of capital stock of the Corporation or a Subsidiary corporation, unless the purchase price of the Option Shares subject to said Stock Option is at least 110% of the Fair Market Value of the Option Shares, determined as of the date said Stock Option is granted.

(d) MAXIMUM VALUE OF STOCK OPTIONS. Except as provided in paragraph (e) of this Section 6, the maximum aggregate Fair Market Value of Option Shares (determined as of the respective Stock Option grant dates) for which an Eligible Participant may be granted Incentive Stock Options in any calendar year shall not exceed \$100,000, plus any "unused carryover amount." The unused carryover amount, determined on a yearly basis, shall be equal to one-half (1/2) of the difference between \$100,000 and the aggregate Fair Market Value (determined as of the respective Stock Option grant dates) of all of the Option Shares subject to Incentive Stock Options granted to the Optionee during the calendar year under the Plan. The provisions of Section 422A(c)(4) of the Internal Revenue Code of 1986, as amended, are incorporated herein by this reference for

9

the purpose of the determination and application of the unused carryover amount.

The aggregate fair market value (determined at the time the option is granted) of the stock with respect to which incentive stock options are exercisable for the first time by such individual under the terms of the Plan during any calendar year is limited to \$100,000, but the value of stock for which options may be granted to an employee in a given year may exceed \$100,000, but such options in excess of \$100,000 shall be treated as non-qualified options.

(e) SUBSTITUTED STOCK OPTIONS. If all of the outstanding shares of common stock of another corporation are changed into or exchanged solely for common stock in a transaction to which Section 425(a) of the internal Revenue Code of 1986, as amended, applies, then, subject to the approval of the Board of Directors of the Bank, Stock Options under the Plan may be substituted ("Substituted Options") in exchange for valid, unexercised and unexpired stock options of such other corporation. Substituted options shall qualify as Incentive Stock Options under the Plan, provided that (and to the extent) the stock options exchanged for the Substituted Options were "Incentive Stock Options" within the meaning of Section 422A of the Internal Revenue Code of 1986, as amended.

(f) NON-QUALIFIED STOCK OPTIONS. All Stock Options granted by the Stock Option Committee which: (i) are designated at the time of grant as Incentive Stock Options but do not so qualify under the provisions of Section 422A of the Code or any regulations or rulings issued by the Internal Revenue Service for any

10

reason; (ii) are in excess of the fair market value limitations set forth in Section 6(d); or (iii) are designated at the time of grant as Non-Qualified Stock Options, shall be deemed Non-Qualified Stock Options under this Plan. Non-Qualified Stock Options granted or substituted hereunder shall be so designated in the stock option agreement entered into between the Corporation and the Optionee.

#### 7. STOCK OPTION EXERCISE PRICE

(a) MINIMUM PRICE. The exercise price of any Option Shares shall be determined by the Stock Option Committee, in its sole and absolute discretion, upon the grant of a Stock Option. Except as provided elsewhere herein, said exercise price shall not be less than one hundred percent (100%) of the Fair Market Value of the Common Stock represented by the Option Share on the date of grant of the related Stock Option.

(b) EXCHANGED STOCK OPTIONS. Where the outstanding shares of stock of another corporation are changed into or exchanged for shares of Common Stock of the Corporation without monetary consideration to that other corporation, then, subject to the approval of the Board or Directors of the Corporation, Stock Options may be granted in exchange for unexercised, unexpired stock options of the other corporation, and the exercise price of the Option Shares subject to each Stock Option so granted may be fixed at a price less than one hundred percent (100%) of the Fair Market Value of the Common Stock at the time such Stock Option is granted if said exercise price has been computed to be not less than the exercise price set forth in the stock option of the other

11

corporation, with appropriate adjustment to reflect the exchange ratio of the shares of stock of the other corporation into the shares of Common Stock of the Corporation.

(c) SUBSTITUTED OPTIONS. The exercise price of the Option Shares subject to each Substituted Option may be fixed at a price less than one hundred percent (100%) of the Fair Market Value of the Common Stock at the time such Substituted option is granted if said exercise price has been computed to be not less than the exercise price set forth in the stock option of the other corporation for which it was exchanged, with appropriate

adjustment to reflect the exchange ratio of the shares of stock of the other corporation into the shares of Common Stock.

## 8. EXERCISE OF STOCK OPTIONS.

(a) EXERCISE. Except as otherwise provided elsewhere herein, each Stock Option shall be exercisable in such increments, which need not be equal, and upon such contingencies as the Stock Option Committee shall determine at the time of grant of the Stock Option; provided, however, (i) that if an Optionee shall not in any given period exercise any part of a Stock Option which has become exercisable during that period, the Optionee's right to exercise such part of the Stock Option shall continue until expiration of the Stock Option or any part thereof as may be provided in the related Stock Option Agreement, and (ii) in the case of options that are not granted to officers, directors, consultants of, or others with significant and material business relationships with, the Company, a minimum

12

of 20% of the stock options shall be exercisable in each year over a five year period from the date the option is granted. No Stock Option or part thereof shall be exercisable except with respect to whole shares of Common Stock, and fractional share interests shall be disregarded except that they may be accumulated.

(b) PRIOR OUTSTANDING INCENTIVE STOCK OPTIONS. Incentive Stock Options granted to an Optionee may be exercisable while such Optionee has outstanding and unexercised any Incentive Stock Option previously granted (or substituted) to him or her pursuant to this Plan. The Stock Option Committee shall determine if such options shall be exercisable if there are any Incentive Stock Options previously granted (or substituted) to him or her pursuant to this Plan, and such determination shall be evidenced in the Agreement executed by the Optionee and Company, subject to the requirements of Rule 260.141.41(f) of the California Commissioner of Corporations. An Incentive Stock Option shall be treated as outstanding until it is exercised in full or expires by reason of lapse of time.

(c) NOTICE AND PAYMENT. Stock Options granted hereunder shall be exercised by written notice delivered to the Corporation specifying the number of Option Shares with respect to which the Stock Option is being exercised, together with concurrent payment in full of the exercise price as hereinafter provided in Section 8(d) hereof. If the Stock Option is being exercised by any person or persons other than the Optionee, said notice shall be accompanied by proof, satisfactory to counsel for the Corporation, of the right to such person or persons to exercise the

13



Stock Option. The Corporation's receipt of a notice of exercise without concurrent receipt of the full amount of the exercise price shall not be deemed an exercise of a Stock Option by an Optionee, and the Corporation shall have no obligation to an Optionee for any Option Shares unless and until full payment of the exercise price is received by the Corporation in accordance with Section 8(d) hereof, and all of the terms and provisions of the Plan and the related stock option agreement have been complied with.

(d) PAYMENT OF EXERCISE PRICE. The exercise price of any Option Shares purchased upon the proper exercise of a Stock Option shall be paid in full at the time of each exercise of a Stock Option in cash and/or, with the prior written approval of the Stock Option Committee, in Common Stock of the Corporation which, when added to the cash payment, if any, has an aggregate Fair Market Value equal to the full amount of the exercise price of the Stock Option, or part thereof, then being exercised and/or, with the prior written approval of the Stock Option Committee and if legally permitted, on a deferred basis evidenced by a promissory note, containing such terms and subject to such security as the Stock Option Committee shall determine to be fair and reasonable from time to time, for the total option price for the number of shares so purchased. No Director may purchase any Stock Option on a deferred basis evidenced by a promissory note. Unless payment is on a deferred basis, payment by an Optionee as provided herein shall be made in full concurrently with the Optionee's notification to the Corporation of his intention to exercise all or part of a Stock Option. If all or part of

14

payment is made in shares of Common Stock as heretofore provided, such payment shall be deemed to have been made only upon receipt by the Corporation of all required share certificates, and all stock powers and other required transfer documents necessary to transfer the shares of Common Stock to the Corporation.

(e) REORGANIZATION. Notwithstanding any provision in any stock option agreement pertaining to the time of exercise of a Stock Option, or part thereof, upon adoption by the requisite holders of the Corporation's outstanding shares of Common Stock of any plan of dissolution, liquidation, reorganization, merger, consolidation or sale of all or substantially all of the assets of the Corporation to another corporation, or the acquisition of stock representing more than 50% of the voting power of the Corporation then outstanding, by another corporation or person, which would, upon consummation, result in termination of a Stock Option in accordance with Section 16 hereof, the Stock Option shall become immediately exercisable as to all Option Shares, whether or not vested, for such period of time as may be determined by the Stock Option Committee, but in any event not less than 30 days prior to the adoption of the plan of dissolution, liquidation, reorganization, merger, consolidation, sale, or acquisition on the condition

that the terminating event described in Section 16 hereof is consummated. Any Option Shares not exercised will be terminated. If such Terminating Event is not consummated, Stock Options granted pursuant to the Plan shall be exercisable in accordance with their respective terms.

15

(f) MINIMUM EXERCISE. Not less than ten (10) Option Shares may be purchased at any one time upon exercise of a Stock Option unless the number of shares purchased is the total number which remains to be purchased under the Stock Option.

(g) COMPLIANCE WITH LAW. No shares of Common Stock shall be issued by the Corporation upon exercise of any Stock Option, and an Optionee shall have no rights or claim to such shares, unless and until: (a) payment in full as provided in Section 8(d) hereof has been received by the Corporation; (b) in the opinion of the counsel for the Corporation, all applicable registration requirements of the Securities Act of 1933, all applicable listing requirements of securities exchanges or associations on which the Corporation's Common Stock is then listed or traded, and all other requirements of law and of regulatory bodies having jurisdiction over such issuance and delivery, have been fully complied with; and (c) if required by federal or state law or regulation, the Optionee shall have paid to the Corporation the amount, if any, required to be withheld on the amount deemed to be compensation to the Optionee as a result of the exercise of his or her Stock Option, or made other arrangements satisfactory to the Corporation, in its sole discretion, to satisfy applicable income tax withholding requirements.

#### 9. NONTRANSFERABILITY OF STOCK OPTIONS.

Each Stock Option shall, by its terms, be nontransferable by the Optionee other than by will or the laws of descent and distribution, and shall be exercisable

16

during the Optionee's lifetime only by the Optionee or his or her guardian or legal representative.

#### 10. CONTINUATION OF EMPLOYMENT

Except for Optionees with a written contract for any definite term, this Agreement shall not obligate the Corporation or a Subsidiary to employ Optionee.

#### 11. CESSATION OF EMPLOYMENT

Except as provided in Sections 8(e), 12, 13, 14, 15 or 16 hereof or as provided in this Section 11, if, for any reason, an Optionee's status as an Eligible Participant is terminated, the Stock Options granted to such Optionee shall expire on the expiration dates specified for said Stock Options at the time of their initial grant, or three (3) months after the Optionee's status as an Eligible Participant is terminated, whichever is earlier. Notwithstanding the foregoing, except as provided in Section 12, the Stock Option Committee may decide upon grant of any Stock Option that upon any termination, the Stock Options will become completely or partially exercisable, and that the permitted period of exercise may continue for any additional period up to the original term of the Stock Option. Thereafter, Options shall be exercisable only as to those increments, if any, which had become exercisable as of such expiration date, and any Stock Options or increments which had not become exercisable as of such date shall expire and terminate automatically on such expiration date.

## 12. TERMINATION FOR VIOLATION OF STANDARDS OF CONDUCT AS REFERENCED IN OPTIONEE'S

17

### EMPLOYEE HANDBOOK

If Optionee's status as an Eligible Participant is terminated for violation of the Employer's Standards of Conduct, the vested portion of Stock Options granted to such Optionee shall be exercisable for a thirty (30) day period following such termination, and thereafter such Stock Options shall automatically expire and terminate in their entirety; provided, however, that the Stock Option Committee may, in its sole discretion, within thirty (30) days of such termination, reinstate such Stock Options to the status of options terminated for reasons other than violations of the Employer's Standards of Conduct, death or disability by giving written notice of such reinstatement to the Optionee. In the event of such reinstatement, the Optionee may exercise the Stock Options as provided in Section 11 herein. Reasons for termination for violation of the Employer's Standards of Conduct shall include, but not be limited to, termination for malfeasance or gross misfeasance in the performance of duties or conviction of illegal activity in connection therewith, and, in any event, the determination of the Stock Option Committee with respect thereto shall be final and conclusive.

## 13. DEATH OF OPTIONEE

If an Optionee loses his status as an Eligible Participant by reason of death, or if an Optionee dies during the three-month period referred to in Section 12 hereof, the Stock Options granted to such Optionee shall expire on the expiration dates specified for said Stock Options at the time of their initial grant, or one (1) year after the date of such death, whichever is earlier. After such death but before

such expiration, subject to the terms and provisions of the Plan and the related stock option agreements, the person or persons to whom such Optionee's rights under the Stock Options shall have passed by will or by the applicable laws of descent and distribution, or the executor or administrator of the Optionee's estate, shall have the right to exercise such Stock Options to the extent that increments, if any, had become exercisable as of the date on which the Optionee's status as an Eligible Participant had been lost.

#### 14. DISABILITY OF OPTIONEE

If an Optionee is disabled while employed by or while serving as a director of the Corporation or a Subsidiary or during the three-month period referred to in Section 12 hereof, the Stock Options granted to such Optionee shall expire on the expiration dates specified for said Stock Options at the time of their initial grant, or one (1) year after the date of such disability, whichever is earlier. After such disability but before such expiration, the Optionee or a guardian or conservator of the Optionee's estate, as duly appointed by a court of competent jurisdiction, shall have the right to exercise such Stock Options to the extent that increments, if any, had become exercisable as of the date on which the Optionee became disabled or ceased to be employed by the Corporation or a Subsidiary as a result of the disability. For the purpose of this Section 14, an Optionee shall be deemed to have become "disabled" if it shall appear to the Stock Option Committee, upon written certification delivered to the Corporation by a qualified licensed physician, that the Optionee has become permanently and totally unable to engage in any

substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death, or which has lasted or can be expected to last for a continuous period of not less than 12 months.

#### 15. ADJUSTMENT UPON CHANGES IN CAPITALIZATION

If the outstanding shares of Common Stock of the Corporation are increased, decreased, or changed into or exchanged for a different number or kind of shares or securities of the Corporation, through a reorganization, merger, recapitalization, reclassification, stock split, stock dividend, stock consolidation, or otherwise, without consideration to the Corporation, an appropriate and proportionate adjustment shall be made in the number and kind of shares as to which Stock Options may be granted. A corresponding adjustment changing the number or kind of Option Shares and the exercise prices per share allocated to unexercised Stock Options, or portions thereof, which shall have been granted prior to any such change, shall likewise be

made. Any such adjustment, however, in an outstanding Stock Option shall be made without change in the total price applicable to the unexercised portion of the Stock Option, but with a corresponding adjustment in the price for each Option Share subject to the Stock Option. Any adjustment under this Section shall be made by the Stock Option Committee, whose determination as to what adjustments shall be made, and the extent thereof, shall be final and conclusive. No fractional shares of stock shall be issued or made available under the Plan on account of any such adjustment, and

20

fractional share interests shall be disregarded and the fractional share interest shall be rounded down to the nearest whole number.

#### 16. TERMINATING EVENTS

Not less than thirty (30) days prior to consummation of a plan of dissolution or liquidation of the Corporation, or consummation of a plan of reorganization, merger or consolidation of the Corporation with one or more corporations, as a result of which the Corporation is not the surviving corporation and the outstanding securities of the class then subject to options hereunder are changed or exchanged for cash or property or securities not of the Corporation's issue, or upon the sale of all or substantially all the assets of the Corporation to another corporation, or the acquisition of stock representing more than fifty percent (50%) of the voting power of the Corporation then outstanding by another corporation or person (the "Terminating Event"), the Stock Option Committee or the Board of Directors shall notify each Optionee of the pendency of the Terminating Event. Upon the effective date of the Terminating Event, the Plan shall automatically terminate and all Stock Options theretofore granted shall terminate, unless provision is made in connection with such transaction for the continuance of the Plan and/or assumption of Stock Options theretofore granted, or substitution for such Stock Options with new stock options covering stock of a successor employer corporation, or a parent or subsidiary corporation thereof, solely at the discretion of such successor corporation, or parent or subsidiary corporation, with appropriate adjustments as to number and kind of shares and prices, in which event the Plan

21

and options theretofore granted shall continue in the manner and under the terms so provided. If the Plan and unexercised options shall terminate pursuant to the foregoing sentence, all persons shall have the right to exercise any unexercised portions of options outstanding and not exercised, shall have the right, at such time prior to the consummation of the transaction causing such termination as the Corporation shall designate and for a period of not less than 30 days, to exercise all unexercised portions of their options, including the portions which would, but for this paragraph entitled "Terminating Events," not yet be exercisable.

## 17. AMENDMENT AND TERMINATION

The Board of Directors of the Corporation may at any time and from time-to-time suspend, amend, or terminate the Plan and may, with the consent of Optionee, make such modifications of the terms and conditions of a Stock Option as it shall deem advisable; provided that, except as permitted under the provisions of Section 16 hereof, no amendment or modification may be adopted without the Corporation having first obtained all necessary regulatory approvals and approval of the holders of a majority of the Corporation's shares of Common Stock present, or represented, and entitled to vote at a duly held meeting of shareholders of the Corporation if the amendment or modification would:

(a) materially increase the benefits accruing to participants under the Plan;

(b) materially increase the number of securities which may be issued under the Plan;

22

(c) materially modify the requirements as to eligibility for participation in the Plan;

(d) increase or decrease the exercise price of any Stock Options granted under the Plan;

(e) increase the maximum term of Stock Options provided for herein;

(f) permit Stock Options to be granted to any person who is not an Eligible Participant; or

(g) change any provision of the Plan which would affect the qualification as an Incentive Stock Option under the Plan.

No Stock Option may be granted during any suspension of the Plan or after termination of the Plan. Amendment, suspension, or termination of the Plan shall not (except as otherwise provided in Section 17 hereof), without the consent of the Optionee, alter or impair any rights or obligations under any Stock Option theretofore granted.

## 18. RIGHTS OF ELIGIBLE PARTICIPANTS AND OPTIONEES

Neither any Eligible Participant, any Optionee or any other person shall have any claim or right to be granted any Stock Option under this Plan, and neither this Plan nor any action taken hereunder shall be deemed or construed as giving any Eligible Participant, Optionee or any other person any right to be retained in the employ of the Corporation or any subsidiary of the

Corporation. Without limiting the generality of the foregoing, there is no vesting of any right in the classification

23

of any person as an Eligible Participant or Optionee, such classification being used solely to define and limit those persons who are eligible for consideration of the grant of Stock Options under the Plan.

19. PRIVILEGES OF STOCK OWNERSHIP; SECURITIES LAW COMPLIANCE; NOTICE OF SALE

No Optionee shall be entitled to the privileges of stock ownership as to any Option Shares not actually issued and delivered. No Option Shares may be purchased upon the exercise of a Stock Option unless and until all then applicable requirements of all regulatory agencies having jurisdiction and all applicable requirements of securities exchanges upon which the stock of the Corporation is listed (if any) shall have been fully complied with. The Corporation will diligently endeavor to comply with all applicable securities laws before any options are granted under the Plan and before any stock is issued pursuant to options. The Optionee shall, not more than five (5) days after each sale or other disposition of shares of Common Stock acquired pursuant to the exercise of Stock Options, give the Corporation notice in writing of such sale or other disposition.

The Corporation will provide to each Optionee its Annual Report as required by Section 260.140.46 of the regulations of the California Commissioner of Corporations.

20. EFFECTIVE DATE OF THE PLAN

The Plan shall be deemed adopted as of February 23, 1999, and shall be effective immediately, subject to approval of the Plan by the holders of at least a

24

majority of the Corporation's outstanding shares of Common Stock and approval of the Plan by the California Commissioner of Corporations.

21. TERMINATION

Unless previously terminated as aforesaid, the Plan shall terminate ten (10) years from the earliest date of (i) adoption of the Plan by the Board of Directors, or (ii) approval of the Plan by holders of at least a majority of the Corporation's outstanding shares of Common Stock. No Stock Options shall be granted under the Plan thereafter, but such termination shall not affect any Stock Option theretofore granted.

## 22. OPTION AGREEMENT

Each Stock Option granted under the Plan shall be evidenced by a written stock option agreement executed by the Corporation and the Optionee, and shall contain each of the provisions and agreements herein specifically required to be contained therein, and such other terms and conditions as are deemed desirable by the Stock Option Committee and are not inconsistent with the Plan.

## 23. STOCK OPTION PERIOD

Each Stock Option and all rights and obligations thereunder shall expire on such date as the Stock Option Committee may determine, but not later than ten (10) years from the date such Stock Option is granted, and shall be subject to earlier termination as provided elsewhere in the Plan.

## 24. EXCULPATION AND INDEMNIFICATION OF STOCK OPTION COMMITTEE

25

In addition to such other rights of indemnification which they may have as directors of the Corporation or as members of the Stock Option Committee, the present and former members of the Stock Option Committee, and each of them, shall be indemnified by the Corporation for and against all costs, judgments, penalties and reasonable expenses, including reasonable attorney's fees, actually and necessarily incurred by them in connection with any action, suit or proceeding, or in connection with any appeal thereof, to which they or any of them may be a party by reason of any act or omission of any member of the Stock Option Committee under or in connection with the Plan or any Stock Option granted thereunder; provided, however, that a member of the Stock Option Committee shall not be entitled to any indemnification whatsoever pursuant to this Section for or as a result of any act or omission of such member which was not taken in good faith and which constituted willful misconduct or gross negligence by such member; provided further, that any amounts paid by any member of the Stock Option Committee in settlement of any action, suit or proceeding for which indemnification may be sought pursuant to this Section shall be first approved in writing by independent legal counsel selected by the Corporation; and, provided further, that within thirty (30) days after institution of any action, suit or proceeding against any member with respect to which such member is entitled to indemnification hereunder, such member shall, in writing, offer the Corporation the opportunity, at its own expense, to handle (including settle) and conduct the

26

defense thereof. The provisions of this Section shall apply to the estate, executor and administrator of each member of the Stock Option Committee.



25. (Reserved)

27

26. NOTICES

All notices and demands of any kind which the Stock Option Committee, any Optionee, Eligible Participant, or any other person may be required or desires to serve under the terms of this Plan shall be in writing and shall be served by personal service upon the respective person or by leaving a copy of such notice or demand at the address of such person as may be reflected in the records of the Corporation, or in the case of the Stock Option Committee, with the Secretary of the Corporation, or by mailing a copy thereof by certified or registered mail, postage prepaid, with return receipt requested. In the case of service by mail, it shall be deemed complete at the expiration of the third day after the day of mailing, except for notice of the exercise of any Stock Option and payment of the Stock Option exercise price, both of which must be actually received by the Corporation.

27. (Reserved)

28. LIMITATION OF RIGHTS

The Stock Option Committee, in its sole and absolute discretion, is entitled to determine who, if anyone, is an Eligible Participant under this Plan, and which, if any, Eligible Participant shall receive any grant of a Stock Option. No oral or written agreement by any person on behalf of the Corporation relating to this Plan or any Stock Option granted hereunder is authorized, and such agreement may not bind the Corporation or the Stock Option Committee to grant any Stock Option to any person.

28

29. SEVERABILITY

If any provision of this Plan as applied to any person or to any circumstances shall be adjudged by a court of competent jurisdiction to be void, invalid, or unenforceable, the same shall in no way effect any other provision hereof, the application of any such provision in any other circumstances, or the validity of enforceability hereof.

30. CONSTRUCTION

Where the context or construction requires, all words applied in the plural shall be deemed to have been used in the singular and vice versa, and the masculine gender shall include the feminine and the neuter.

31. HEADINGS

The headings of the several paragraphs of this Plan are inserted solely for convenience of reference and are not intended to form a part of and are not intended to govern, limit or aid in the construction of any term or provision hereof.

32. SUCCESSORS

This Plan shall be binding upon the respective successors, assigns, heirs, executors, administrators, guardians and personal representatives of the Corporation and any Optionee.

33. GOVERNING LAW

This Plan shall be governed by and construed in accordance with the laws of the State of California.

34. CONFLICT

29

In the event of any conflict between the terms and provisions of this Plan, and any other document, agreement or instrument, including, without limitation, any stock option agreement, the terms and provisions of this Plan shall control.

SECRETARY'S CERTIFICATE OF ADOPTION

I, the undersigned, do hereby certify:

1. That I am the duly elected and acting Assistant Secretary of Pacific Community Banking Group; and

2. That the foregoing Pacific Community Banking Group 1999 Stock Option Plan was duly adopted by the Board of Directors of Pacific Community Banking Group as the Stock Option Plan for the Corporation at a meeting duly called as required by law and convened on the 23rd day of February, 1999, as amended on July 27, 1999.

IN WITNESS WHEREOF, I have hereunto subscribed my name and affixed the seal of the Corporation this 27th day of July, 1999.

-----  
Margaret Howe, Assistant Secretary

[SEAL]

CONSENT OF INDEPENDENT PUBLIC ACCOUNTANTS

As independent public accountants, we hereby consent to the use of our reports (and all references to our Firm) included in or made a part of this registration statement.

ARTHUR ANDERSEN LLP

Orange County, California  
July 26, 1999

[McGladrey & Pullen LLP Letterhead]

CONSENT OF INDEPENDENT ACCOUNTANTS

We hereby consent to the use in this Registration Statement on Form S-1 (No. 333-76403) of our report dated January 15, 1999, relating to the financial statements of Valley Bank. We also consent to the reference to our Firm under the caption "Experts" in the Prospectus.

/s/ McGladrey & Pullen LLP

Pasadena, California

July 27, 1999