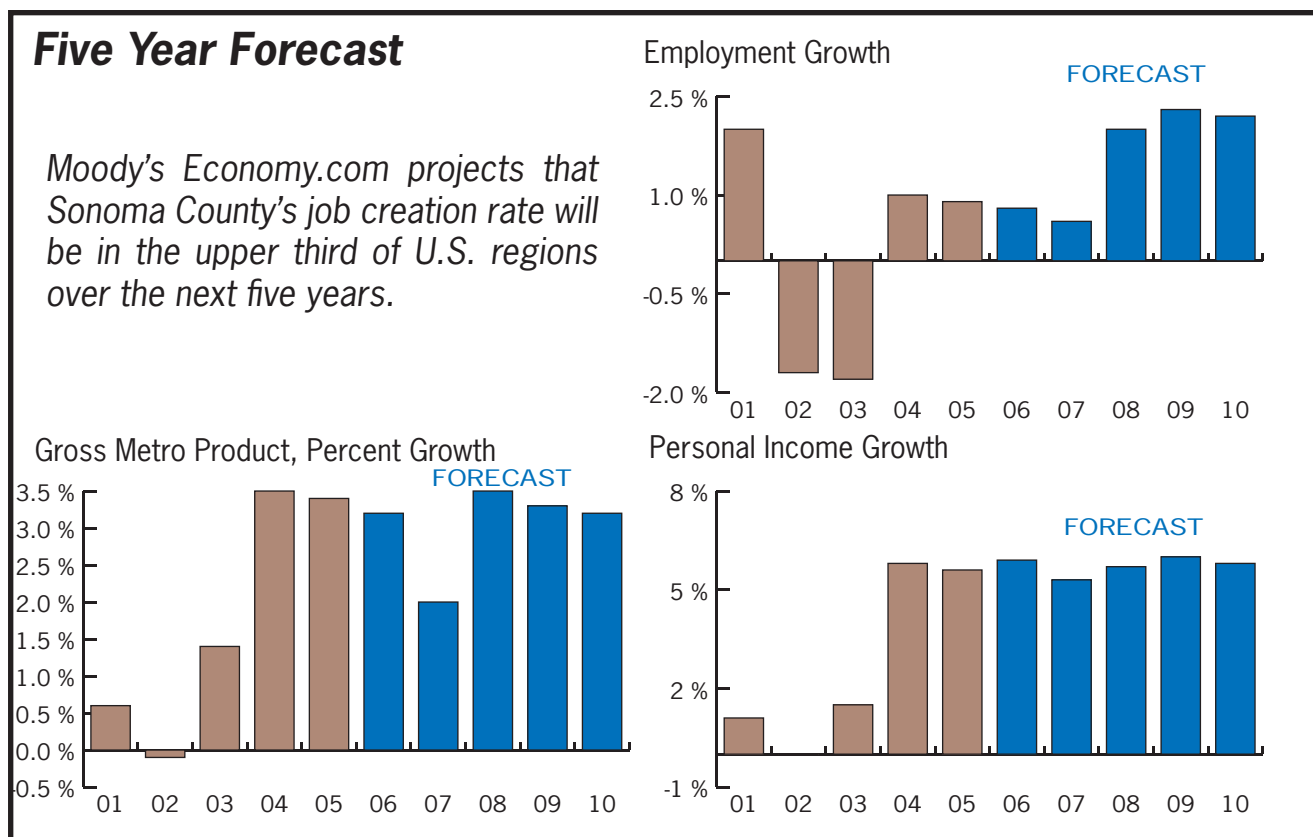




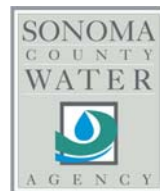
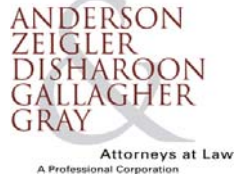
In This Report:

- **The outlook for Sonoma County remains very moderate with the potential for considerable near-term volatility** depending upon the speed and depth of the housing market adjustment.
- **Sonoma County's unemployment rate remains remarkably low**, the result of a shrinking labor force over the past year as estimated by the Bureau of Labor Statistics.
- **The housing market has cooled considerably.** The California Association of Realtors reports prices for single-family homes peaked in January and unsold inventories are their highest since 2003.
- **The pace of economic growth will not likely pick up until early to mid-2007.** Longer term, Sonoma will be closer to an average performer.
- **Brad Zigler reports on the recent performance of local stocks.** Brad Zigler is a Santa Rosa-based financial writer and editor, and is the creator of the North Bay Stock Index.





**With Acknowledgment and Appreciation to the Underwriters of the
Economic Development Board Foundation Research Initiatives Program
Sonoma County Permit & Resources Management Dept. ■ Community Development Commission
■ Sonoma County Health Services ■ Sonoma County Transportation & Public Works**



SONOMA COUNTY

EMPLOYMENT GROWTH RANK

Best=1 Worst=387

2005-07

283
4th quintile

2005-10

120
2nd quintile

LIFE CYCLE PHASE

Mature/Decline

Best=1 Worst=379

VITALITY

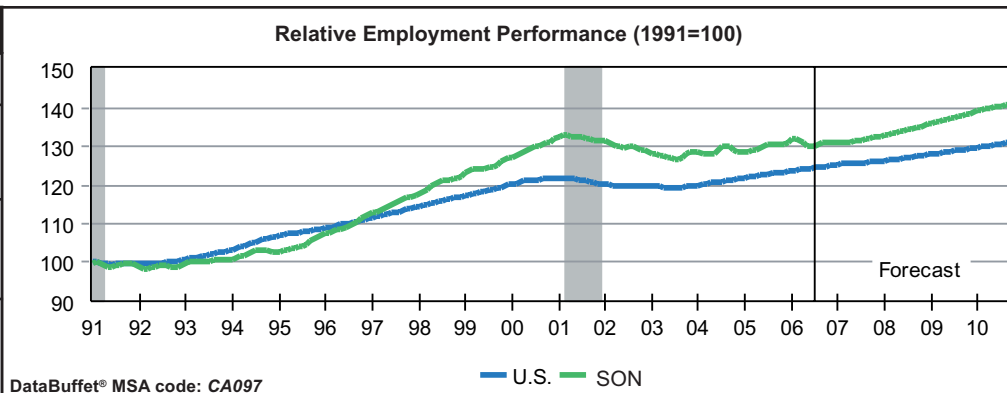
306
4th quintile

COST OF DOING BUSINESS

U.S.=100% **110%**

COST OF LIVING

U.S.=100% **135%**



DataBuffet® MSA code: CA097

— U.S. — SON

1999	2000	2001	2002	2003	2004	2005	Indicators	2006	2007	2008	2009	2010
14.5	16.0	16.1	16.1	16.3	16.9	17.5	Gross Metro Product, C\$B	18.0	18.4	19.0	19.7	20.3
9.7	10.3	0.6	-0.1	1.4	3.5	3.4	% Change	3.2	2.0	3.5	3.3	3.2
179.3	186.1	189.8	186.6	183.2	185.0	186.6	Total Employment (000)	188.0	189.1	192.9	197.2	201.6
3.6	3.8	2.0	-1.7	-1.8	1.0	0.9	% Change	0.8	0.6	2.0	2.3	2.2
2.7	3.3	3.6	5.1	5.5	4.9	4.4	Unemployment Rate	4.1	4.3	4.2	4.0	3.9
5.8	14.8	1.1	-0.0	1.5	5.8	5.6	Personal Income Growth	5.9	5.3	5.7	6.0	5.8
453.4	460.5	465.6	465.8	467.2	467.9	466.5	Population (000)	467.7	470.8	477.2	485.4	493.8
2,348	2,013	1,717	1,350	1,503	1,342	1,598	Single-Family Permits	1,499	2,138	2,161	2,101	2,075
688	492	866	578	749	587	1,221	Multifamily Permits	571	659	760	750	784
284.0	359.2	408.3	436.5	490.8	575.2	682.5	Existing Home Price (\$Ths)	722.9	737.4	738.9	749.1	773.3
4,417	3,941	9,310	11,382	16,524	10,896	9,694	Mortgage Originations (\$Mil)	8,201	7,296	6,388	6,476	6,759
6.1	5.6	3.7	-1.4	-0.4	-1.0	-3.3	Net Migration (000)	-0.7	1.2	4.3	5.9	6.0
1,627	1,158	1,183	1,223	1,300	1,267	1,997	Personal Bankruptcies	1,238	1,439	1,526	1,579	1,701

STRENGTHS & WEAKNESSES

STRENGTHS

- Demand is improved for technology-based products made in SON.
- Leisure and business travel is holding steady.
- Household balance sheets are in good shape.

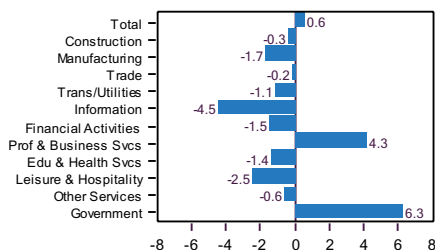
WEAKNESSES

- Housing market is faltering.
- Weak population and labor force growth.
- Several basic driving industries are not hiring.

CURRENT EMPLOYMENT TRENDS

July 2006 Employment Growth

% change year ago, 3 mo. MA



FORECAST RISKS

SHORT TERM ↓ LONG TERM ↓ RISK-ADJUSTED RETURN, '05-10 **-0.03%**

UPSIDE

- U.S. economy accelerates in early 2007, generating stronger domestic demand for consumer and intermediate goods.
- Fuel prices tumble, supporting travel industry.

DOWNSIDE

- Business investment spending falters, leaving behind SON's tech-producing industries.
- Rising global supply and quality of wine limit margins of local producers.

ANALYSIS

Recent Performance. Sonoma County's (SON) economy is expanding unevenly at a very moderate pace. Manufacturing still faces a number of closings and consolidations and many service industries are paring workers. Nevertheless, the unemployment rate remains remarkably low, the result of a shrinking labor force over the past year as estimated by the Bureau of Labor Statistics. The housing market reflects the weak pace of economic growth, with a moderate downturn in prices and unsold inventory that has more than doubled over the past year.

Technology. SON's tech-related manufacturers have been on a rollercoaster ride for much of the past two years, but the general trend in hiring is still downward as the industry consolidates. The latest closure was at TriVascular, which laid off 270 workers when it closed its local facilities. Yet, other med-tech firms, such as Medtronic, maintain good potential. Indeed, Medtronic has placed surplus local land on the market to raise R&D funds, an indication of continued support of its local unit.

Also, makers of technology that support telecom services maintain growth potential as the U.S. telecom industry is back on its feet and seeking productivity enhancing gear. Turin Networks, for example, is enjoying some success with its high-bandwidth Ethernet transmission equipment for businesses and carriers. But hiring among other tech-producing industries remains weak locally.

Wine and Tourism. This segment of the economy remains very healthy. This year's wine grape crop may not match last year's record tonnage, but it should be good and domestic demand for wine appears to be holding up, particularly at higher price points. Indeed, the ability to move up and out of the competitive lower-priced markets is one comparative advantage for Sonoma County winemakers. SON's travel industry had a very good summer this year and, with fuel prices beginning to edge lower, the

outlook is improving for stable visitor arrivals through the fall and winter seasons.

Weaknesses. Still, economic stability is not strong enough for continued hiring in leisure and hospitality services or in business and professional services, for which payrolls have fallen substantially since the beginning of this year. Neither retailing nor construction provides additional support. Construction payrolls already have shrunk back to their level of one year ago following a spike in residential construction in late 2005.

Housing. The housing market has cooled considerably. The California Association of Realtors reports prices for single-family homes peaked in January and unsold inventories are their highest since 2003. The turn in the housing market has been as sharp and sudden as it was during the 2001 recession. Inventories, while rising, still remain moderate in historical terms, but they continue to rise.

Economic Links. A return of commercial air service to SON planned for March is jeopardized by the federal government's apparent inability to provide security screening services. If this remains the case, the economy will lose the potential boost from added direct air links to southern California and the Pacific Northwest.

The outlook for Sonoma County remains very moderate with the potential for considerable near-term volatility depending upon the speed and depth of the housing market adjustment. While rising short-term interest rates do put stress on homeowners with adjustable-rate financing, delinquency rates rose only moderately through the first half of the year, indicating that household balance sheets, so far, remain in good shape. Nevertheless, the pace of economic growth will not likely pick up until early to mid-2007. Longer term, SON will be closer to an average performer.

Steven G. Cochrane
September 2006

EMPLOYMENT & INDUSTRY

TOP EMPLOYERS

County of Sonoma	3,935
Kaiser Permanente	2,200
St. Joseph Health System	1,918
Agilent Technologies	1,900
Medtronic Vascular	1,290
Sutter Medical Center of Santa Rosa	1,024
Safeway, Inc.	960
Kendall-Jackson Wine Estates	920
Home Depot	900
Amy's Kitchen	832
JDS Uniphase Corporation	800
Albertsons, Inc.	780
River Rock Casino	701
Hansel Auto Group	652
Wal-Mart Stores, Inc.	610
AT&T California	600
State Farm Insurance Company	566
Washington Mutual	560
Longs Drug Stores, Inc.	550
Beam Wine Estates	500
Pacific Gas and Electric Company	500

Source: North Bay Business Journal - Sonoma County, Feb 2006
County of Sonoma

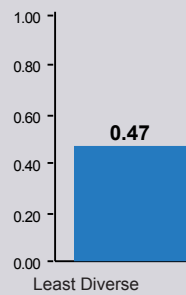
Public

Federal	1,700
State	5,392
Local	23,370

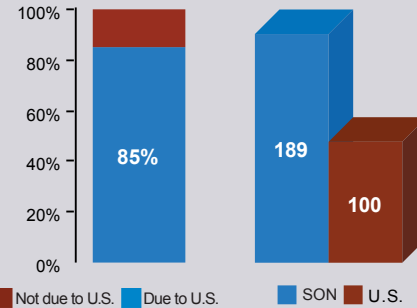
2005

INDUSTRIAL DIVERSITY

Most Diverse (U.S.)



EMPLOYMENT VOLATILITY DUE TO U.S. FLUCTUATIONS RELATIVE TO U.S.

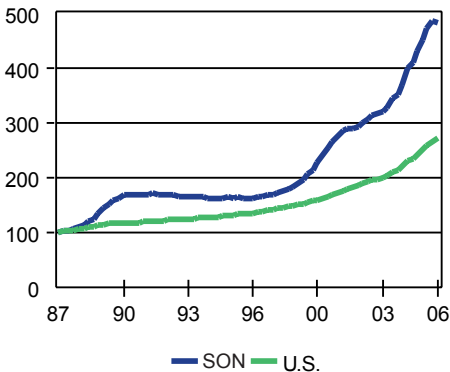


COMPARATIVE EMPLOYMENT AND INCOME

Sector	% of Total Employment			Average Annual Earnings		
	SON	CA	US	SON	CA	US
Construction	7.7%	6.1%	5.5%	\$56,988	\$56,542	\$45,869
Manufacturing	12.7%	10.2%	10.7%	\$63,724	\$74,953	\$65,803
Durable	51.7%	64.0%	62.9%	nd	\$82,956	\$68,019
Nondurable	48.3%	36.0%	37.1%	nd	\$61,262	\$62,134
Transportation/Utilities	2.0%	3.3%	3.7%	\$51,115	\$61,436	\$55,375
Wholesale Trade	3.9%	4.6%	4.3%	\$57,560	\$64,639	\$63,130
Retail Trade	12.7%	11.2%	11.4%	\$30,759	\$32,687	\$26,719
Information	2.0%	3.2%	2.3%	\$65,377	\$100,169	\$80,020
Financial Activities	5.2%	6.3%	6.1%	\$42,155	\$55,688	\$53,576
Prof. and Bus. Services	10.9%	14.5%	12.6%	\$39,800	\$52,997	\$48,978
Educ. and Health Services	12.1%	10.7%	13.0%	\$42,315	\$43,429	\$39,628
Leisure and Hosp. Services	11.0%	10.0%	9.6%	\$17,410	\$23,521	\$19,325
Other Services	3.3%	3.5%	4.0%	\$25,215	\$24,741	\$23,364
Government	16.3%	16.3%	16.3%	\$51,929	\$59,880	\$52,846

Sources: Percent of total employment - Moody's Economy.com & BLS, 2005; Average annual earnings - BEA, 2004

HOUSE PRICES



Source: OFHEO, 1987Q1=100, NSA

CREDIT QUALITY

MOODY'S
RATING

County **Aa2**

LEADING INDUSTRIES

NAICS Industry	Employees (000)
GVSL State & Local Government	28.8
FR Farms	8.7
7221 Full-Service Restaurants	7.5
3121 Beverage Manufacturing	6.3
6221 General Medical and Surgical Hospitals	5.8
7222 Limited-Service Eating Places	5.4
4451 Grocery Stores	5.2
2360 Construction of Buildings	4.0
7211 Traveler Accommodation	3.3
5617 Services to Buildings and Dwellings	3.3
5613 Employment Services	3.0
2383 Building Finishing Contractors	2.9
2382 Building Equipment Contractors	2.7
4521 Department Stores	2.6
6211 Offices of Physicians	2.5
High-tech employment	10.1
As % of total employment	5.0

Sources: BLS, Moody's Economy.com, 2005

MIGRATION FLOWS

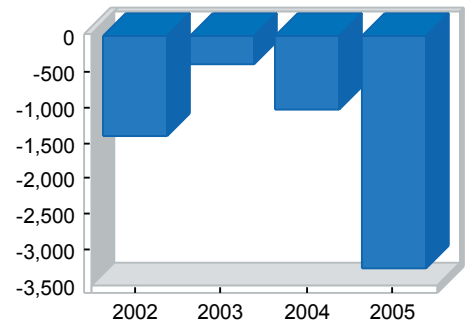
Into Sonoma County	Number of Migrants	Median Income
San Francisco CA	3,352	36,702
Oakland CA	1,164	30,204
Sacramento CA	700	25,070
San Jose CA	549	41,315
Napa CA	545	32,272
Los Angeles CA	545	23,199
Vallejo CA	424	32,499
San Diego CA	273	19,166
Riverside CA	248	20,323
Santa Ana CA	205	26,249
Total Immigration	14,117	26,582

From Sonoma County

San Francisco CA	2,053	32,109
Sacramento CA	1,446	32,668
Oakland CA	963	28,959
Vallejo CA	519	36,022
Napa CA	474	31,847
San Diego CA	466	22,307
Los Angeles CA	461	21,102
Phoenix AZ	397	29,361
San Jose CA	383	35,226
Riverside CA	323	25,692
Total Outmigration	17,496	27,297

Net Migration	-3,379	-715
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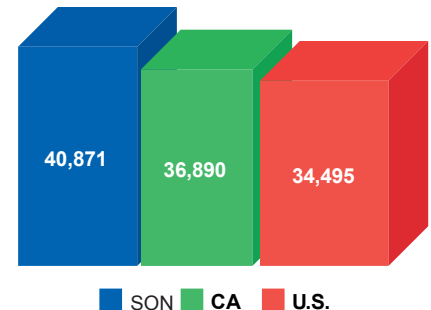
Net Migration, SON



	2002	2003	2004	2005
Domestic	-4,088	-2,927	-3,351	-5,380
Foreign	2,680	2,540	2,323	2,120
Total	-1,408	-387	-1,028	-3,260

Sources: IRS (top), 2004; Census Bureau 2005

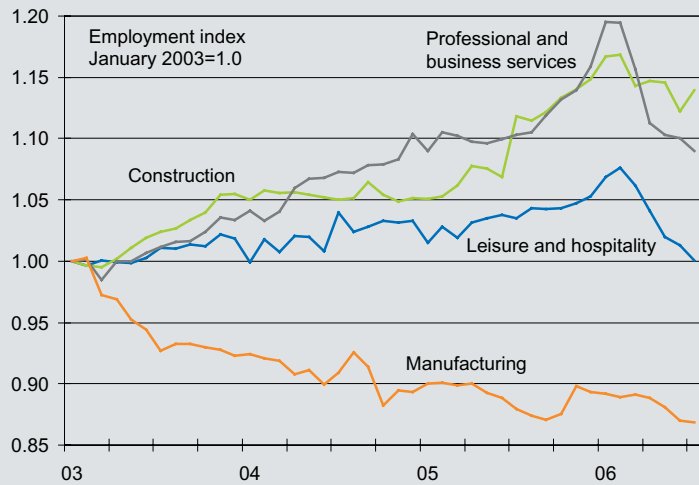
PER CAPITA INCOME



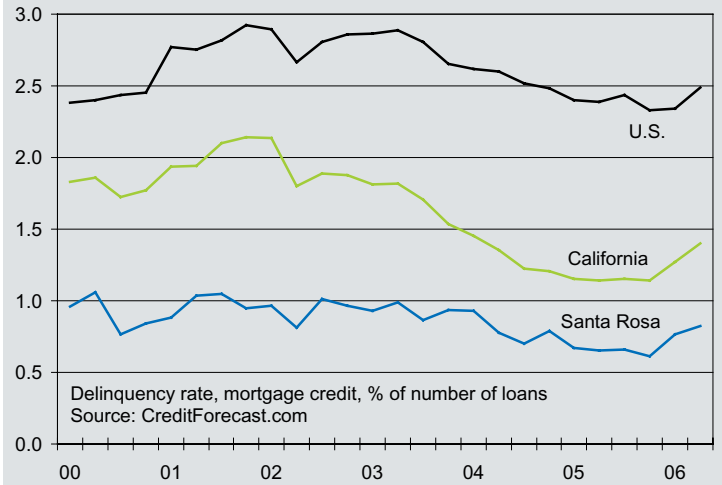
Source: Bureau of Economic Analysis, 2005

Sonoma County

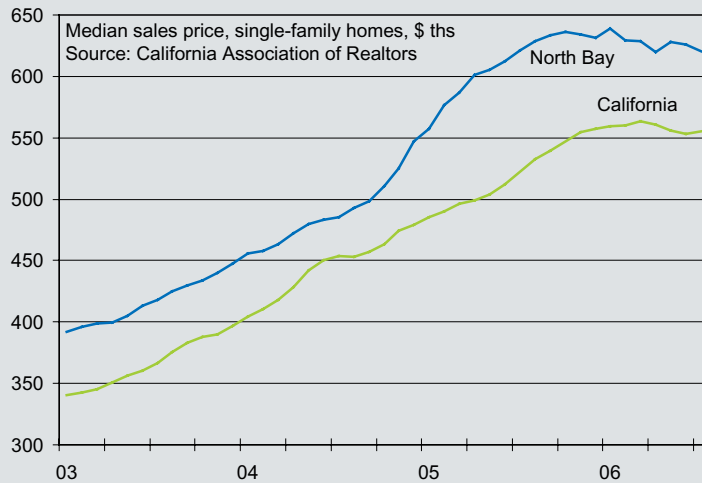
Driving Industries Falter in 2006



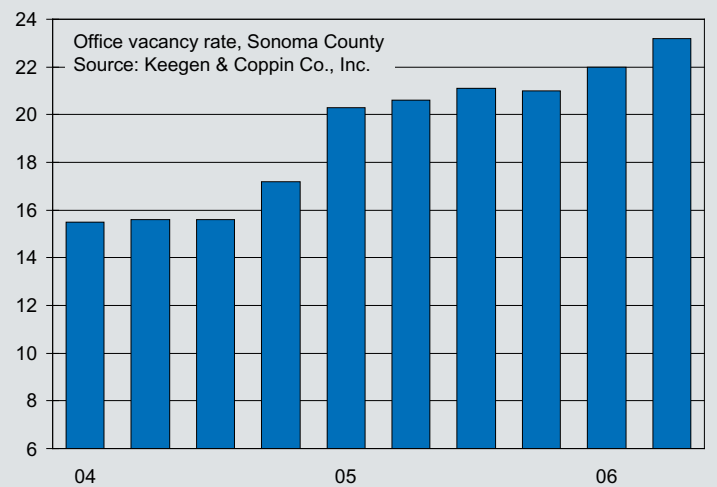
Mortgage Credit Conditions Remain Good in Sonoma County



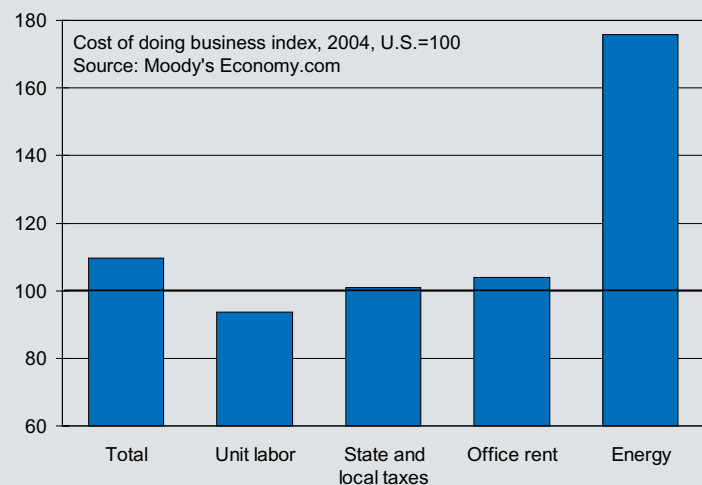
House Prices Have Passed Their Peak



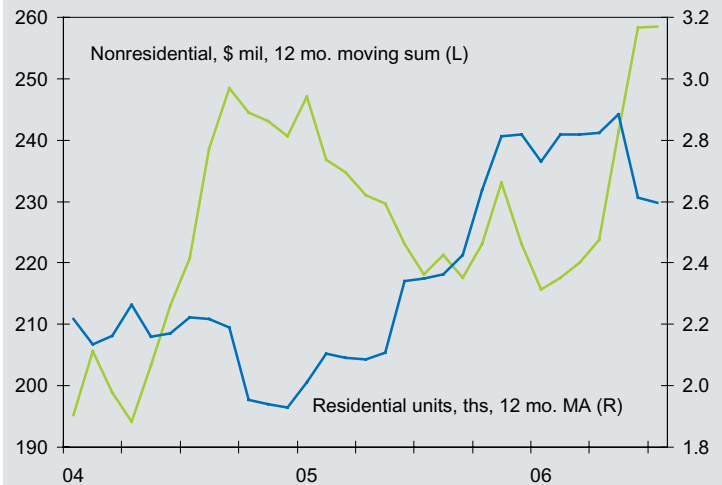
Office Vacancy Rates Keep Climbing with Weak Labor Market



It Is Not the Labor That Is Expensive in Sonoma County



Nonresidential Construction Improves as Housing Fades



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SONOMA COUNTY STOCKS: REVERSING TREND

This report was prepared by Brad Zigler, a Santa Rosa-based financial writer and editor. Mr. Zigler's work has appeared in the Journal of Indexes, Institutional Investor, Financial Planning, Financial Advisor, Mutual Funds, Futures, Registered Rep. and the North Bay Business Journal, among other publications. Previously the head of marketing, research and education at the Pacific Exchange and Barclays Global Investors, Mr. Zigler is the creator of the North Bay Stock Index. He holds investments in some of the Sonoma County-based securities mentioned in this report.

THINGS CHANGE

It's not been a great year for equities. Some stocks, of course, will outperform others at any given time. There's a certain amount of rotation to be expected, too, as yesterday's market leaders become today's laggards. Such is the case for local stocks.

Sonoma County stocks outperformed the blue-chip Dow Jones Industrial Average in the first quarter of 2006, but by September, a significant reversal had taken hold. The Dow's first quarter gain of 3.7 percent stretched to 7.0 percent while the 5.3 percent gain of indigenous issues turned into a 4.9 percent loss.

A rotation from small-cap into large-cap issues accounts for some of the reversal, though the squeeze on bank margins is probably the larger culprit.

While local stocks continue to exhibit a bit less volatility than their large-market neighbors, the reward-to-risk advantage once offered by Sonoma stocks has now evaporated. In the first quarter, Sonoma County stocks earned a 1.89 Sharpe ratio,¹ versus the Dow's .92 reading. By fall, the Dow's ratio was halved to .46. Sonoma stocks' contemporaneous Sharpe ratio sank to -1.32.

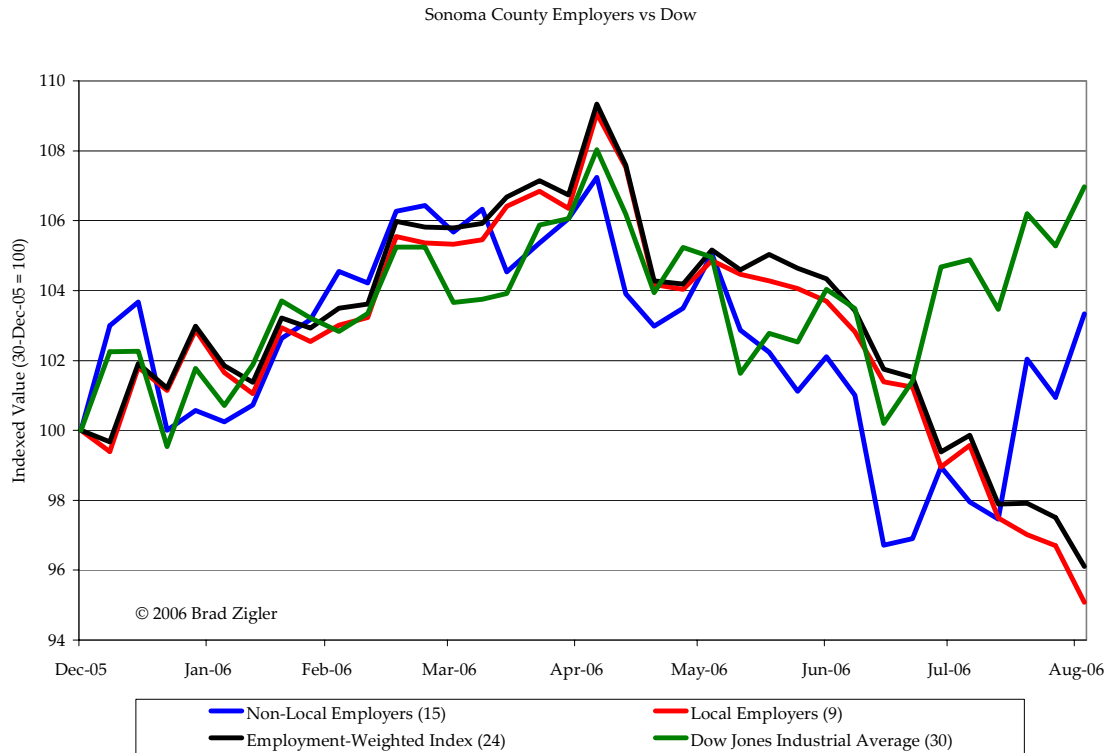
Figure 1 illustrates the year-to-date performance of local stocks compared to the Dow (in **green**). For further comparison, the stocks of nine locally headquartered companies (in **red**) are put up against those Sonoma County's 15 largest publicly traded employers² (in **blue**) headquartered elsewhere. The **black** line is an employment-weighted index of the public companies operating in Sonoma County. Each stock's heft in the index is determined by the proportion of Sonoma County jobs to the company's total employment base. The weighting can be thought of as an approximation of Sonoma County employees' contribution to each stock's performance.

Non-local employers earned a 3.3 percent return through September 1 on a price-weighted basis, a return fairly well-correlated to the performance of the Dow. But when weighted for Sonoma County employment, the stock performance of these stocks turned negative. Combined with Sonoma County-based employers, the collective return of these 24 stocks falls to -3.9 percent

¹ The Sharpe ratio represents the payback, in terms of a return over the Treasury bill rate, earned for assuming portfolio risk. Sharpe ratios in excess of 1.00 indicate more-than-adequate risk compensation. Sharpe ratios in this report are based on *annualized* returns, not returns for the year-to-date period.

² These include: Agilent Technologies, Albertson's/Supervalu, AT&T, Cisco Systems, Federated Department Stores, Home Depot, JDS Uniphase, Longs Drug Stores, Medtronic, New York Times Co., PG&E, Safeway, Tellabs, Washington Mutual and Wal-Mart Stores.

Figure 1



The median Sonoma County-based stock gained 11 percent since the beginning of the year as winners outpaced losers by a 5-to-3 margin. Figure 2 provides details on each locally-headquartered stock.

Figure 2

**Locally Headquartered Stock Performance
YTD through 1-Sep-06**

	Industry	1-Sep-06 Price	YTD Gain/Loss	Sharpe Ratio	Liquidity Index
ZAP (ZP)	Recreation/ & Other Vehicles	\$1.27	388.5%	2.97	\$62,719
Sonoma Valley Bancorp (SBNK)	Regional Bank	\$27.05	26.4%	1.68	\$27,582
SonomaWest Holdings Inc. (SWHI)	Rental/Leasing	\$12.50	22.0%	0.79	\$6,115
Northern Empire Bancshares (NREB)	Regional Bank	\$23.67	0.0%	0.00	\$291,630
Summit State Bank (SSBI)	Regional Bank	\$13.99	-6.7%	-2.13	\$174,018
Burst.com (BRST)	Software/Programming	\$0.95	-11.2%	-0.25	\$22,545
Exchange Bank Santa Rosa (EXSR)	Regional Bank	\$130.50	-12.0%	-1.60	\$66,280
Tegal Corp. (TGAL)	Semiconductor Equipment	\$0.35*	-39.3%	-1.26	\$4,145
Sonoma College, Inc. (SNMA)	Education/Training	\$0.12	-88.5%	-0.83	\$585
Median		\$13.25	-6.7%	-0.25	\$27,582

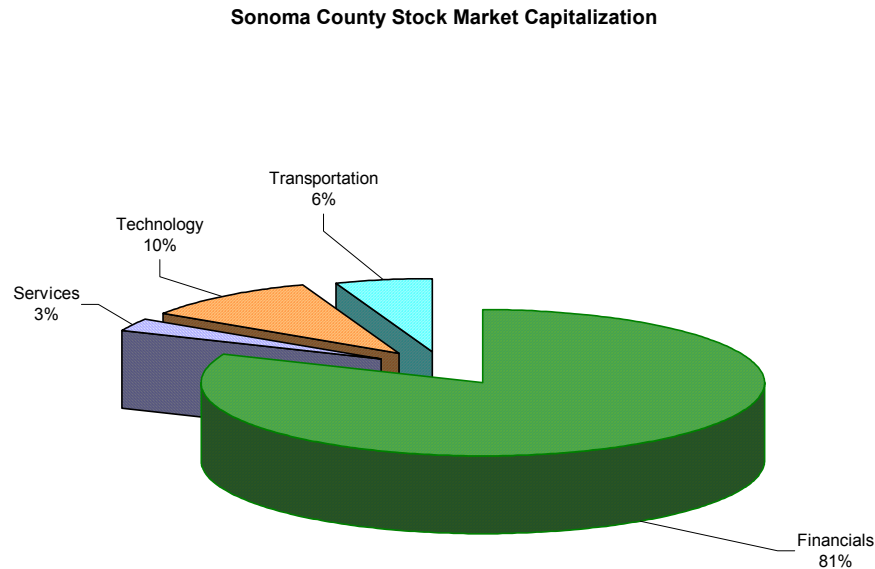
* Price reflects 12-for-1 reverse split

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BREAKDOWN BY INDUSTRY

The indigenous market remains heavily skewed in favor of financial issues, owing largely to the hefty price of Exchange Bank's stock. Fully 92 percent of the local stock set's price weight derives from regional bank stocks, though these issues represent only 81 percent of total market capitalization.

Figure 3



Transportation

This one-stock sector earned a 2.97 Sharpe ratio through September 1. Transportation represents a mere 0.3 percent of local market employment.

- ZAP (ZP) - Hardly out of the penny stock category, ZP provides the best reward-to-risk ratio of any Sonoma County stock. Investors, however, have to stomach considerable volatility to hold this issue.

Services

Accounting for 35.2 percent of local employment among publicly traded companies, the services industry's 3.9 percent gain earned a Sharpe ratio of 0.52 through September 1.

- SonomaWest Holdings, Inc. (SWHI) - Once a management-led buyout of the company was scotched in June, SonomaWest's stock price settled at the \$12-\$13 range.

- Sonoma College, Inc (SNMA) - Without a dedicated market maker to call its own, bids for Sonoma College's stock have continued their decline. A half-million dollar private financing deal, closed in August, further diluted the stock.

Financials

Financial institutions account for 9.5 percent of the public company employment base in Sonoma County. As a group, five financial companies lost 0.5 percent on an employment-weighted basis through September 1. Earning a composite -1.40 Sharpe ratio, pressure on bank interest margins remains unabated.

- Sonoma Valley Bancorp (SBNK) - The county's smallest bank earned a 26.4 percent year-to-date return, maintaining its top billing among its peers. Record earnings were posted for the second quarter, attributed to loan growth, higher operating efficiencies, and increases in non-interest income.
- Northern Empire Bancshares (NREB) - The parent of Sonoma National Bank struggled against a ten-basis point decline in its net interest margin with growing loan volume and cost controls. As of September 1, NREB shares were about even with January price levels.
- Summit State Bank (SSBI) - After going public at \$15 in July, Summit's share price struggled to find its footing below the \$14 level after underwriter support was withdrawn.
- Exchange Bank-Santa Rosa (EXSR) - The share price of Sonoma County's largest bank swooned 12 percent through September 1. A near doubling of interest expense weighed heavily on the bank's income statement.

Technology

Tech companies, at 41.7 percent, are the largest contributor to the Sonoma County employment base. Tech stocks rose 1.2 percent on an employment-weighted basis, garnering a -0.27 Sharpe ratio..

- Burst.com (BRST) - The Santa Rosa-based software maker's stock remains buoyed by the prospect of a settlement in a patent infringement suit against Apple Computer.
- Tegal Corp. (TGAL) - TGAL's headquarter move to Silicon Valley was delayed in the wake of a 1-for 12 reverse stock split.

DIVIDENDS

The median annual dividend yield on Sonoma Sector stocks stands at 2.36 percent as of September '1. Dividends were contributed by three regional bank stocks—Exchange Bank, Sonoma Valley Bancorp and Summit State Bank. By comparison, the annual yield on three-month Treasury bills has averaged 4.63 percent so far this year.

LIQUIDITY

Sonoma County stocks, despite their small capitalization, continue to exhibit pockets of significant liquidity. Median market capitalization in Sonoma County stands at \$47.9 million. The median

liquidity index, representing the size of a transaction necessary to move an issue's price by one percentage point, is a shade over \$27,000. The most liquid issue is Northern Empire Bancshares., with an index over \$291,000; least liquid, with a \$585 reading, is Sonoma College.

Figure 4

Locally Headquartered Stock Fundamentals
YTD through 1-Sep-06

	Average Volume	Shares Outstanding (mm)	Market Cap (\$mm)	Price/ Earnings	Price/ Book	Dividend Yield
ZAP (ZP)	254,833	33.7	42.7			
Sonoma Valley Bancorp (SBNK)	514	27.1	61.6	17.1	2.5	2.2%
SonomaWest Holdings Inc. (SWHI)	71	1.1	14.1	17.3	2.4	
Northern Empire Bancshares (NREB)	28,000	10.9	258.1	14.9	2.2	
Summit State Bank (SSBI)	4,000	4.8	65.2	7.4	8.3	2.6%
Burst.com (BRST)	20,714	27.0	47.9	4.8		
Exchange Bank Santa Rosa (EXSR)	275	1.7	225.4	11.6	1.8	3.1%
Tegal Corp. (TGAL)	18,800	7.0	28.9		1.2	
Sonoma College, Inc. (SNMA)	3,500	63.9	7.7			
Median	4,000	10.9	47.9	13.3	2.3	2.6%

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INSIDER TRANSACTIONS

Officers and directors of Sonoma Valley Bancorp were most active with respect to their company's stock. More than \$507,000 in net purchases of SBNK stock, all option related, were made since the beginning of 2006.

NEW ENTRIES

Recently, the stock of Santa Rosa's Atlantic Pacific Bank commenced trading under the ticker symbol APFB but as of this report, trading is bound at \$10.05 per share. Additional information on APFB will be incorporated in the next report.

Also, Oculus Innovative Sciences, a Petaluma healthcare company, is now readying a public offering.

***Note:** The foregoing information and discussion on Sonoma County stock performance was obtained by the County of Sonoma from Mr. Zigler and is presented for the convenience of the reader. Any opinions expressed are solely those of Mr. Zigler and not of the County of Sonoma. The information provided here is not intended to replace other stock performance reports, investment publications, and the like and should not be used as the sole source for investment decisions. You should perform your own research and evaluation before making any investment decisions. Although the information presented here is believed to be accurate, the County of Sonoma does not guarantee its accuracy and assumes no liability for investment results that may occur following your use of the information provided herein.*