UNITED SECURITY BANCSHARES
Form 10-Q/A
September 07, 2012

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q
(Amendment No. 1)

xQUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2012

oTRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM______ TO .

Commission file number: 000-32987

UNITED SECURITY BANCSHARES
(Exact name of registrant as specified in its charter)

CALIFORNIA (State or other jurisdiction of incorporation or organization)	91-2112732 (I.R.S. Employer Identification No.)
2126 Inyo Street, Fresno, California (Address of principal executive offices)	93721 (Zip Code)

Registrants telephone number, including area code (559) 248-4943

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yesx No o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act).
Large accelerated filer o Accelerated filer o Non-accelerated filer o Small reporting company x

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

Aggregate market value of the Common Stock held by non-affiliates as of the last business day of the registrant's most recently completed second fiscal quarter - June 30, 2012: $32,991,096

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Stock, no par value
(Title of Class)

Shares outstanding as of July 31, 2012: 13,803,806

TABLE OF CONTENTS

Facing Page

Table of Contents

PART I. Financial Information

Item 1.	Financial Statements	
	Consolidated Balance Sheets	3
	Consolidated Statements of Operations and Comprehensive (Loss) Income	4
	Consolidated Statements of Changes in Shareholders' Equity	5
	Consolidated Statements of Cash Flows	6
	Notes to Consolidated Financial Statements	7
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	33
	Overview	33
	Results of Operations	37
	Financial Condition	41
	Asset/Liability Management – Liquidity and Cash Flow	50
	Regulatory Matters	51
Item 4.	Controls and Procedures	55

PART II. Other Information

Item 1.	Legal Proceedings	58
Item 1A.	Risk Factors	58
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	58
Item 3.	Defaults Upon Senior Securities	58
Item 4.	Mine Safety Disclosures	58
Item 5.	Other Information	58
Item 6.	Exhibits	58

Signatures 59

Table of Contents

Explanatory Note

The sole purpose of this Amendment No. 1 to the Company's Form 10-Q for the quarter ended June 30, 2012, originally filed with the United States Securities and Exchange Commission (SEC) on August 14, 2012 (the Initial Form 10-Q), is to furnish Exhibit 101 to the Initial Form 10-Q. Exhibit 101 contains the XBRL (eXtensible Business Reporting Language) interactive data files for the financial statements and notes included in Part I, Item 1 of the Form 10-Q. As permitted by Rule 405(a)(2) of Regulation S-T, Exhibit 101 is being furnished by amendment within 30 days of the first quarterly period in which detailed footnote tagging is required.

No other changes have been made to the Initial Form 10-Q and the Initial Form 10-Q has not been updated to reflect events occurring subsequent to the original filing date.

PART I. Financial Information

United Security Bancshares and Subsidiaries
Consolidated Balance Sheets – (unaudited)
June 30, 2012 and December 31, 2011

(in thousands except shares)	June 30, 2012	December 31, 2011
Assets		
Cash and due from banks	$22,400	$28,052
Cash and due from FRB	76,990	96,132
Cash and cash equivalents	99,390	124,184
Interest-bearing deposits in other banks	2,103	2,187
Investment securities available for sale (at fair value)	35,553	38,458
Loans and leases	395,081	408,715
Unearned fees	(518)	(569)
Allowance for credit losses	(11,610)	(13,648)
Net loans	382,953	394,498
Accrued interest receivable	1,755	1,946
Premises and equipment – net	12,566	12,675
Other real estate owned	23,894	27,091
Intangible assets	383	553
Goodwill	4,488	4,488
Cash surrender value of life insurance	16,413	16,150
Investment in limited partnerships	3,677	4,149
Deferred income taxes - net	11,153	11,485 11,485
Other assets	11,279	13,468
Total assets	$605,607	$651,332
Liabilities & Shareholders' Equity		
Liabilities		
Deposits		
Noninterest bearing	$197,052	$224,907
Interest bearing	327,950	349,520
Total deposits	525,002	574,427
Accrued interest payable	95	111

Accounts payable and other liabilities	5,417	5,594
Junior subordinated debentures (at fair value)	9,276	9,027
Total liabilities	539,790	589,159
Shareholders' Equity		
Common stock, no par value 20,000,000 shares authorized, 13,803,806 and 13,531,832 issued and outstanding, in 2012 and 2011, respectively	42,087	41,435
Retained earnings	24,029	21,447
Accumulated other comprehensive loss	(299)	(709)
Total shareholders' equity	65,817	62,173
Total liabilities and shareholders' equity	$605,607	$651,332

See notes to consolidated financial statements;;

Table of Contents

United Security Bancshares and Subsidiaries
Consolidated Statements of Operations and Comprehensive Income
(Unaudited)

	Quarter Ended June 30,		Six Months Ended June 30,	
(In thousands except shares and EPS)	2012	2011 (As restated)	2012	2011(As restated)
Interest Income:				
Loans, including fees	$5,966	$ 6,437	$12,009	$ 12,857
Investment securities – AFS – taxable	457	540	978	1,137
Interest on deposits in FRB	43	43	94	94
Interest on deposits in other banks	10	10	20	20
Total interest income	6,476	7,030	13,101	14,108
Interest Expense:				
Interest on deposits	437	668	915	1,436
Interest on other borrowings	72	83	136	168
Total interest expense	509	751	1,051	1,604
Net Interest Income Before				
Provision for Credit Losses	5,967	6,279	12,050	12,504
Provision for Credit Losses	1,004	9,161	1,006	10,051
Net Interest Income	4,963	(2,882)	11,044	2,453
Noninterest Income:				
Customer service fees	897	894	1,801	1,761
Increase in cash surrender value of bank-owned life insurance	144	140	280	281
Gain (Loss) on sale of other real estate owned	275	(324)	337	(44)
Gain (Loss) on fair value of financial liability	364	222	(112)	(145)
Gain on sale of other investment	1,807	0	1,807	0
Other	177	242	445	449
Total noninterest income	3,664	1,174	4,558	2,302
Noninterest Expense:				
Salaries and employee benefits	2,176	2,220	4,598	4,541
Occupancy expense	840	909	1,605	1,802
Data processing	19	19	37	43
Professional fees	439	980	683	1,419
FDIC/DFI insurance assessments	417	475	783	988
Director fees	69	58	136	116
Amortization of intangibles	79	158	170	320
Correspondent bank service charges	80	78	160	154
Impairment loss on core deposit intangible	0	0	0	36
Impairment loss on goodwill	0	1,489	0	1,489
Impairment loss on investment securities (cumulative total other-than-temporary loss of $3.6 million,net of $1.3 million recognized in other comprehensive loss, pre-tax)	149	0	172	0
Impairment loss on OREO	0	438	0	1,122
Loss on California tax credit partnership	81	103	184	209
OREO expense	(18)	719	666	951
Other	646	594	1,272	1,107

Total noninterest expense	4,977	8,240	10,466	14,297
Income (Loss) Before Provision for Taxes	3,650	(9,948)	5,136	(9,542)
Provision (Benefit)for Taxes on Income	1,478	(3,599)	1,912	(3,549)
Net Income (Loss)	$2,172	$ (6,349)	$3,224	$ (5,993)
Other comprehensive income (loss), net of tax:				
Unrealized gain (loss) on available for sale securities, and past service costs of employee benefit plans – net of income tax expense (benefit) of $237, $(282), $273 and $(305).	355	(423)	410	(458)
Comprehensive Income (Loss)	$2,527	$ (6,772)	$3,634	$ (6,451)
Net Income (Loss) per common share				
Basic	$0.16	$ (0.46)	$0.23	$ (0.43)
Diluted	$0.16	$ (0.46)	$0.23	$ (0.43)
Shares on which net income per common shares were based				
Basic	13,803,806	13,803,806	13,803,806	13,803,806
Diluted	13,803,806	13,803,806	13,803,806	13,803,806

See notes to consolidated financial statements

4

Table of Contents

United Security Bancshares and Subsidiaries
Consolidated Statements of Changes in Shareholders' Equity
(unaudited)

(In thousands except shares)	Common stock Number of Shares	Common stock Amount	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance January 1, 2011	13,003,849	39,869	33,807	(406)	73,270
Net changes in unrealized loss on available for sale securities (net of income tax expense of $307)				(461)	(461)
Net changes in unrecognized past service Cost on employee benefit plans (net of income tax benefit of $2)				3	3
Common stock dividends	261,335	828	(828)		0
Stock-based compensation expense		10			10
Net Income			(5,993)		(5,993)
Balance June 30, 2011 (As restated)	13,265,184	$ 40,707	$26,986	$ (864)	$66,829
Net changes in unrealized loss on available for sale securities (net of income tax benefit of $155)				233	233
Net changes in unrecognized past service Cost on employee benefit plans (net of income tax expense of $54)				(78)	(78)
Common stock dividends	266,648	720	(720)		0
Stock-based compensation expense		8			8
Net Loss			(4,819)		(4,819)
Balance December 31, 2011	13,531,832	41,435	21,447	(709)	62,173
Net changes in unrealized loss on available for sale securities (net of income tax expense of $218)				410	410
Common stock dividends	271,974	642	(642)		
Stock-based compensation expense		10			10
Net Income			3,224		3,224
Balance June 30, 2012	13,803,806	42,087	24,029	(299)	65,817

See notes to consolidated financial statements

Table of Contents

United Security Bancshares and Subsidiaries
Consolidated Statements of Cash Flows (unaudited)

	Six Months Ended June 30,	
(In thousands)	2012	2011 (As restated)
Cash Flows From Operating Activities:		
Net Income (Loss)	$3,224	$ (5,993)
Adjustments to reconcile net income:to cash provided by operating activities:		
Provision for credit losses	1,006	10,051
Depreciation and amortization	789	907
Accretion of investment securities	(129)	(31)
Decrease in accrued interest receivable	191	112
(Decrease) in accrued interest payable	(16)	(62)
(Increase) Decrease in accounts payable and accrued liabilities	(40)	615
(Decrease) increase in unearned fees	(51)	(224)
Increase (Decrease) in income taxes payable	1,852	(3,539)
Stock-based compensation expense	10	10
Deferred Income Taxes	(332)	0
(Gain) loss on sale of other real estate owned	(337)	44
Impairment loss on other real estate owned	0	1,122
Impairment loss on core deposit intangible	0	36
Impairment loss on investment securities	172	0
Impairment loss on investment in bank stock	69	0
Impairment loss on goodwill	0	1,489
Increase in surrender value of life insurance	(280)	(264)
Loss on fair value option of financial liabilities	112	145
Loss on tax credit limited partnership interest	184	209 418106
Gain on sale of other investment	(1,807)	0
Net decrease in other assets	349	202
Net cash provided by operating activities	4,966	4,829
Cash Flows From Investing Activities:		
Net decrease in interest-bearing deposits with banks	84	2,127
Redemption of correspondent bank stock	293	299
Maturities, calls and principal payments of available-for-sale securities	3,476	8,014
Purchases of available-for-sale securities	0	(6,546)
Net decrease in loans	10,590	3,653
Cash proceeds from sales of other real estate owned	3,532	2,982
Cash proceeds from sale of other investment	2,174	0
Cash proceeds from sale of premises and equipment	36	0
Investment in limited partnership	0	46
Capital expenditures for premises and equipment	(520)	(553)
Net cash provided by investing activities	19,665	10,022
Cash Flows From Financing Activities:		
Net (decrease) increase in demand deposits and savings accounts	(20,686)	30,263
Net decrease in certificates of deposit	(28,739)	(40,170)
Decrease in other borrowings	0	(7,000)
Net cash used in financing activities	(49,425)	(16,907)

Net (decrease) in cash and cash equivalents	(24,794)	(2,056)
Cash and cash equivalents at beginning of period	124,184	98,430
Cash and cash equivalents at end of period	$99,390	$ 96,374

See notes to consolidated financial statements

6

Table of Contents

United Security Bancshares and Subsidiaries - Notes to Consolidated Financial Statements - (Unaudited)

1.Organization and Summary of Significant Accounting and Reporting Policies

The consolidated financial statements include the accounts of United Security Bancshares, and its wholly owned subsidiary United Security Bank (the “Bank”) and two bank subsidiaries, USB Investment Trust (the “REIT”) and United Security Emerging Capital Fund, (collectively the “Company” or “USB”). Intercompany accounts and transactions have been eliminated in consolidation.

These unaudited financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information on a basis consistent with the accounting policies reflected in the audited financial statements of the Company included in its 2011 Annual Report on Form 10-K. These interim financial statements do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of a normal recurring, nature) considered necessary for a fair presentation have been included. Operating results for the interim periods presented are not necessarily indicative of the results that may be expected for any other interim period or for the year as a whole.

Certain reclassifications have been made to the 2011 financial statements to conform to the classifications used in 2012. Financial information as of June 30, 2011 is as restated and reported on the Company’s form 10Q/A filed with the United States Securities and Exchange Commission (SEC) on November 25, 2011.

New Accounting Standards:

In September 2011, the FASB issued ASU 2011-08, Intangibles - Goodwill and Other (Topic 350) - Testing Goodwill for Impairment. ASU 2011-08 amends Topic 350, Intangibles – Goodwill and Other, to give entities the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events or circumstances, an entity determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test is unnecessary. However, if an entity concludes otherwise, then it is required to perform the first step of the two-step impairment test by calculating the fair value of the reporting unit and comparing the fair value with the carrying amount of the reporting unit. ASU 2011-08 is effective for annual and interim impairment tests beginning after December 15, 2011, and did not have a significant impact on the Company’s financial statements.

In April 2011, the FASB issued ASU No. 2011-02, Receivables (Topic 310): A Creditor’s Determination of Whether a Restructuring Is a Troubled Debt Restructuring. ASU 2011-02 clarifies the guidance in ASC 310-40 Receivables: Troubled Debt Restructurings by Creditors. Creditors are required to identify a restructuring as a troubled debt restructuring if the restructuring constitutes a concession and the debtor is experiencing financial difficulties. ASU 2011-02 clarifies guidance on whether a creditor has granted a concession and clarifies the guidance on a creditor’s evaluation of whether a debtor is experiencing financial difficulties. In addition, ASU 2011-02 also precludes the creditor from using the effective interest rate test in the debtor’s guidance on restructuring of payables when evaluating whether a restructuring constitutes a troubled debt restructuring. The effective date of ASU 2011-2 for public entities is effective for the first interim or annual period beginning on or after June 15, 2011, and should be applied retrospectively to the beginning of the annual period of adoption. If, as a result of adoption, an entity identifies newly impaired receivables, an entity should apply the amendments for purposes of measuring impairment prospectively for the first interim or annual period beginning on or after June 15, 2011. The Company adopted the methodologies prescribed by this ASU during the third quarter 2011 and it did not have a material effect on its financial statements.

7

Table of Contents

In April 2011, the FASB issued ASU 2011-03, Reconsideration of Effective Control for Repurchase Agreements. This ASU was developed to improve the accounting for repurchase agreements (repos) and other agreements that both entitle and obligate a transferor to repurchase or redeem financial assets before their maturity. The amendments in this ASU remove from the assessment of effective control (1) the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee, and (2) the collateral maintenance implementation guidance related to that criterion. The amendments in this ASU apply to all entities, both public and nonpublic. The amendments affect all entities that enter into agreements to transfer financial assets that both entitle and obligate the transferor to repurchase or redeem the financial assets before their maturity. The guidance in this ASU is effective for the first interim or annual period beginning on or after December 15, 2011 and should be applied prospectively to transactions or modifications of existing transactions that occur on or after the effective date. Early adoption is not permitted. This ASU did not have a significant impact on the Company's financial statements.

In May 2011, the FASB issued ASU 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. The amendments in this ASU result in common fair value measurement and disclosure requirements in U.S. GAAP and IFRSs. Consequently, the amendments change the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. The amendments in this ASU are to be applied prospectively. For public entities, the amendments are effective during interim and annual periods beginning after December 15, 2011. Early application by public entities is not permitted. This ASU did not have a significant impact on the Company's financial statements.

In June 2011, the FASB issued ASU No. 2011-05, Presentation of Comprehensive Income. ASU 2011-05 requires entities to present the total of comprehensive income, the components of net income and the components of other comprehensive income in a single continuous statement of comprehensive income or in two separate consecutive statements. The effective date for ASU 2011-05 is for the first interim or annual period beginning on or after December 15, 2011. The adoption of ASU 2011-05 did not have a material impact on the Company's results of operations or financial position.

2.Investment Securities Available for Sale and Other Investments

Following is a comparison of the amortized cost and fair value of securities available-for-sale, as of June 30, 2012 and December 31, 2011:

(In thousands) June 30, 2012: Securities available for sale:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value (Carrying Amount)
U.S. Government agencies	$ 21,711	$ 1,129	$ (11)	$ 22,829
U.S. Government collateralized mortgage obligations	4,086	326	0	4,412
Residential mortgage obligations	9,595	0	(1,283)	8,312
Total securities available for sale	$ 35,392	$ 1,455	$ (1,294)	$ 35,553
December 31, 2011: Securities available for sale:	Amortized Cost	Unrealized Gains	Unrealized Losses	(Carrying Amount)
U.S. Government agencies	$ 23,680	$ 1,377	$ (7)	$ 25,050
U.S. Government collateralized mortgage obligations	5,010	425	0	5,435
Residential mortgage obligations	10,238	0	(2,265)	7,973
Total securities available for sale	$ 38,928	$ 1,802	$ (2,272)	$ 38,458

The amortized cost and fair value of securities available for sale at June 30, 2012, by contractual maturity, are shown below. Actual maturities may differ from contractual maturities because issuers have the right to call or prepay obligations with or without call or prepayment penalties. Contractual maturities on collateralized mortgage obligations cannot be anticipated due to allowed paydowns.

Table of Contents

(In thousands)	June 30, 2012 Amortized Cost	Fair Value (Carrying Amount)
Due in one year or less	$ 5,105	$ 5,140
Due after one year through five years	4,313	4,360
Due after five years through ten years	3,439	3,729
Due after ten years	8,854	9,600
Collateralized mortgage obligations	13,681	12,724
	$ 35,392	$ 35,553

There were no realized gains or losses on sales of available-for-sale securities during the six months ended June 30, 2012 or 2011. There were other-than-temporary impairment losses of $149,000 and $172,000 on certain of the Company's private label mortgage-backed securities for the three and six months ended June 30, 2012, respectively. There were no other-than-temporary impairment losses for the six months ended June 30, 2011.

At June 30, 2012 available-for-sale securities with an amortized cost of approximately $13.4 million (fair value of $14.1 million) were pledged as collateral for FHLB borrowings and public funds balances, respectively.

The Company had no held-to-maturity or trading securities at June 30, 2012 or December 31, 2011.

Management periodically evaluates each available-for-sale investment security in an unrealized loss position to determine if the impairment is temporary or other-than-temporary.

The following summarizes temporarily impaired investment securities:

(In thousands)	Less than 12 Months		12 Months or More		Total	
June 30, 2012: Securities available for sale:	Fair Value (Carrying Amount)	Unrealized Losses	Fair Value (Carrying Amount)	Unrealized Losses	Fair Value (Carrying Amount)	Unrealized Losses
U.S. Government agencies	$ 2,128	$ (11)	$ 0	$ 0	$ 2,128	$ (11)
U.S. Government agency collateral mortgage obligations	0	0	0	0	0	0
Residential mortgage obligations	0	0	8,312	(1,283)	8,312	(1,283)
Total impaired securities	$ 2,128	$ (11)	$ 8,312	$ (1,283)	$ 10,440	$ (1,294)
December 31, 2011: Securities available for sale:						
U.S. Government agencies	$ 2,143	$ (7)	$ 0	$ 0	$ 2,143	$ (7)
U.S. Government agency collateral mortgage obligations	0	0	0	0	0	0

Residential mortgage obligations	0	0	7,994	(2,265)	7,994	(2,265)
Total impaired securities	$ 2,143	$ (7)	$ 7,994	$ (2,265)	$ 10,137	$ (2,272)

The Company evaluates investment securities for other-than-temporary impairment ("OTTI") at least quarterly, and more frequently when economic or market conditions warrant such an evaluation. The investment securities portfolio is evaluated for OTTI by segregating the portfolio into two general segments and applying the appropriate OTTI model. Investment securities classified as available for sale or held-to-maturity are generally evaluated for OTTI under ASC Topic 320, "Investments – Debt and Equity Instruments." Certain purchased beneficial interests, including non-agency mortgage-backed securities, asset-backed securities, and collateralized debt obligations, are evaluated under ASC Topic 325-40 "Beneficial Interest in Securitized Financial Assets.")

In the first segment, the Company considers many factors in determining OTTI, including: (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, (3) whether the market decline was affected by macroeconomic conditions, and (4) whether the Company has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. The assessment of whether an other-than-temporary decline exists involves a high degree of subjectivity and judgment and is based on the information available to the Company at the time of the evaluation.

The second segment of the portfolio uses the OTTI guidance that is specific to purchased beneficial interests including private label mortgage-backed securities. Under this model, the Company compares the present value of the remaining cash flows as estimated at the preceding evaluation date to the current expected remaining cash flows. An OTTI is deemed to have occurred if there has been an adverse change in the remaining expected future cash flows.

Table of Contents

Other-than-temporary-impairment occurs when the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss. If an entity intends to sell or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the other-than-temporary-impairment shall be recognized in earnings equal to the entire difference between the investment's amortized cost basis and its fair value at the balance sheet date. If an entity does not intend to sell the security and it is not more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis less any current-period loss, the other-than-temporary-impairment shall be separated into the amount representing the credit loss and the amount related to all other factors. The amount of the total other-than-temporary-impairment related to the credit loss is recognized in earnings, and is determined based on the difference between the present value of cash flows expected to be collected and the current amortized cost of the security. The amount of the total other-than-temporary-impairment related to other factors shall be recognized in other comprehensive (loss) income, net of applicable taxes. The previous amortized cost basis less the other-than-temporary-impairment recognized in earnings shall become the new amortized cost basis of the investment.

At June 30, 2012, the decline in market value for all but three (see below) of the impaired securities is attributable to changes in interest rates, and not credit quality. Because the Company does not have the intent to sell these impaired securities and it is not more likely than not it will be required to sell the securities before their anticipated recovery, the Company does not consider these securities to be other-than-temporarily impaired at June 30, 2012.

At June 30, 2012, the Company had three private label mortgage-backed securities which have been impaired more than twelve months. The three private label mortgage-backed securities had an aggregate fair value of $8.3 million and unrealized losses of approximately $1.3 million at June 30, 2012. All three private label mortgage-backed securities were rated less than high credit quality at June 30, 2012. The Company evaluated these three private label mortgage-backed securities for OTTI by comparing the present value of expected cash flows to previous estimates to determine whether there had been adverse changes in cash flows during the period. The OTTI evaluation was conducted utilizing the services of a third party specialist and consultant in Mortgage Backed Securities (MBS) and Collateralized Mortgage Obligations (CMO) products. The cash flow assumptions used in the evaluation at June 30, 2012 utilized a discounted cash flow valuation technique using a "Liquidation Scenario" whereby loans are evaluated by delinquency and are assigned probability of default and loss factors deemed appropriate in the current economic environment. The liquidation scenarios assume that all loans 60 or more days past due are liquidated and losses are realized over a period of between six and twenty-four months based upon current 3-month trailing loss severities obtained from financial data sources. As a result of the impairment evaluation, the Company determined that there had been adverse changes in cash flows in all three of the private label mortgage-backed securities, and concluded that these three private label mortgage-backed securities were other-than-temporarily impaired. At June 30, 2012, the three private label mortgage-backed securities had cumulative other-than-temporary-impairment losses of $3.6 million, $1.3 million of which was recorded in other comprehensive loss. During the six months ended June 30, 2012, the company recorded OTTI impairment expense of $172,000 on the two private label mortgage-backed securities. During the six months ended June 30, 2011, the company recorded no OTTI impairment expense. These three private label mortgage-backed securities remained classified as available for sale at June 30, 2012.

The following table details the three private label mortgage-backed securities with other-than-temporary-impairment, their credit rating at June 30, 2012, the related credit losses recognized in earnings during the quarter, and impairment losses in other comprehensive loss:

June 30, 2012 (in 000's)	RALI 2006-QS1G A10 Rated D	RALI 2006 QS8 A1 Rated D	CWALT 2007-8CB A9 Rated CCC	Total
Amortized cost – before OTTI	$ 3,719	$ 1,138	$ 7,015	$11,872

Credit loss	(713)	(239)	(1,325)	(2,277)
Other impairment (OCI)	(403)	(122)	(758)	(1,283)
Carrying amount – June 30, 2012	$ 2,603	$ 777	$ 4,932	$ 8,312
Total impairment - June 30, 2012	$ (1,116)	$ (361)	$ (2,083)	$ (3,560)

The total other comprehensive loss (OCI) balance of $1.3 million in the above table is included in unrealized losses of 12 months or more at June 30, 2012.

Table of Contents

The following table summarizes amounts related to credit losses recognized in earnings for the six months and quarters ended June 30, 2012 and 2011.

(in thousands)	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011
Beginning balance - credit losses	2,257	1,795	$ 2,208	$ 1,631
Additions:				
Initial credit impairments	0	0	0	0
Subsequent credit impairments	172	0	149	0
Reductions:				
For securities sold or credit losses realized on principal payments	(152)	(288)	(80)	(124)
Due to change in intent or requirement to sell		0	0	0
For increase expected in cash flows		0	0	0
Ending balance - credit losses	$ 2,277	$ 1,507	$ 2,277	$ 1,507

3.Loans and Leases

Loans are comprised of the following:

(In thousands)	June 30, 2012	December 31, 2011
Commercial and business loans	$ 141,157	$ 163,442
Government program loans	2,500	2,984
Total commercial and industrial	$ 143,657	$ 166,426
Real estate – mortgage:		
Commercial real estate	132,512	118,857
Residential mortgages	25,416	24,031
Home Improvement and Home Equity loans	1,781	1,859
Total real estate mortgage	159,709	144,747
RE construction and development	50,633	50,400
Agricultural	28,957	35,811
Installment	12,095	11,282
Commercial lease financing	30	49
Total Loans	$ 395,081	$ 408,715

The Company's loans are predominantly in the San Joaquin Valley and the greater Oakhurst/East Madera County area, as well as the Campbell area of Santa Clara County, although the Company does participate in loans with other financial institutions, they are primarily in the state of California.

Commercial and industrial loans represent 36.4% of total loans at June 30, 2012 and are generally made to support the ongoing operations of small-to-medium sized commercial businesses. Commercial and industrial loans have a high degree of industry diversification and provide working capital, financing for the purchase of manufacturing plants and

equipment, or funding for growth and general expansion of businesses. A substantial portion of commercial and industrial loans are secured by accounts receivable, inventory, leases, or other collateral including real estate. The remainder are unsecured; however, extensions of credit are predicated upon the financial capacity of the borrower. Repayment of commercial loans generally comes from the cash flow of the borrower.

Real estate mortgage loans, representing 40.4% of total loans at June 30, 2012, are secured by trust deeds on primarily commercial property, but are also secured by trust deeds on single family residences. Repayment of real estate mortgage loans generally comes from the cash flow of the borrower.

Commercial real estate mortgage loans comprise the largest segment of this loan category and are available on all types of income producing and commercial properties, including: office buildings and shopping centers; apartments and motels; owner-occupied buildings; manufacturing facilities and more. Commercial real estate mortgage loans can also be used to refinance existing debt. Although real estate associated with the business is the primary collateral for commercial real estate mortgage loans, the underlying real estate is not the source of repayment. Commercial real estate loans are made under the premise that the loan will be repaid from the borrower's business operations, rental income associated with the real property, or personal assets.

Table of Contents

Residential mortgage loans are provided to individuals to finance or refinance single-family residences. Residential mortgages are not a primary business line offered by the Company, and are generally of a shorter term than conventional mortgages, with maturities ranging from three to fifteen years on average.

Home Equity loans comprise a relatively small portion of total real estate mortgage loans, and are offered to borrowers for the purpose of home improvements, although the proceeds may be used for other purposes. Home equity loans are generally secured by junior trust deeds, but may be secured by 1st trust deeds.

Real estate construction and development loans, representing 12.8% of total loans at June 30, 2012, consist of loans for residential and commercial construction projects, as well as land acquisition and development, or land held for future development. Loans in this category are secured by real estate including improved and unimproved land, as well as single-family residential, multi-family residential, and commercial properties in various stages of completion. All real estate loans have established equity requirements. Repayment on construction loans generally comes from long-term mortgages with other lending institutions obtained at completion of the project.

Agricultural loans represent 7.3% of total loans at June 30, 2012 and are generally secured by land, equipment, inventory and receivables. Repayment is from the cash flow of the borrower.

Commercial lease financing loans, representing less than 0.01% of total loans at June 30, 2012, consist of loans to small businesses, which are secured by commercial equipment. Repayment of the lease obligation is from the cash flow of the borrower.

In the normal course of business, the Company is party to financial instruments with off-balance sheet risk to meet the financing needs of its customers. At June 30, 2012 and December 31, 2011, these financial instruments include commitments to extend credit of $61.3 million and $62.4 million, respectively, and standby letters of credit of $2.9 million and $2.5 million, respectively. These instruments involve elements of credit risk in excess of the amount recognized on the balance sheet. The contract amounts of these instruments reflect the extent of the involvement the Company has in off-balance sheet financial instruments.

The Company's exposure to credit loss in the event of nonperformance by the counterparty to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amounts of those instruments. The Company uses the same credit policies as it does for on-balance sheet instruments.

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. Substantially all of these commitments are at floating interest rates based on the Prime rate. Commitments generally have fixed expiration dates. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary, is based on management's credit evaluation. Collateral held varies but includes accounts receivable, inventory, leases, property, plant and equipment, residential real estate and income-producing properties.

Standby letters of credit are generally unsecured and are issued by the Company to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers.

Table of Contents

Past Due Loans

The Company monitors delinquency and potential problem loans on an ongoing basis through weekly reports to the Loan Committee and monthly reports to the Board of Directors. The following is a summary of delinquent loans at June 30, 2012:

June 30, 2012 (000's)	Loans 30-60 Days Past Due	Loans 61-89 Days Past Due	Loans 90 or More Days Past Due	Total Past Due Loans	Current Loans	Total Loans	Accruing Loans 90 or More Days Past Due
Commercial and Business Loans	$ 1,278	$ 179	$ 531	$ 1,988	$ 139,169	$ 141,157	$ 209
Government Program Loans	638	0	0	638	1,862	2,500	0
Total Commercial and Industrial	1,916	179	531	2,626	141,031	143,657	209
Commercial Real Estate Mortgage Loans	3,243	0	0	3,243	129,269	132,512	0
Residential Mortgage Loans	460	325	0	785	24,631	25,416	0
Home Improvement and Home Equity Loans	89	57	99	245	1,536	1,781	0
Total Real Estate Mortgage	3,792	382	99	4,273	155,436	159,709	0
Total RE Construction and Development Loans	325	0	2,099	2,424	48,209	50,633	0
Total Agricultural Loans	546	0	0	546	28,411	28,957	0
Consumer Loans	539	0	0	539	11,342	11,881	0
Overdraft protection Lines	0	0	0	0	0	0	0
Overdrafts	0	0	0	0	214	214	0
Total Installment/other	539	0	0	539	11,556	12,095	0
Commercial Lease Financing	0	0	0	0	30	30	0

Total Loans	$ 7,118	$ 561	$ 2,729	$ 10,408	$ 384,673	$ 395,081	$ 209

The following is a summary of delinquent loans at December 31, 2011:

December 31, 2011 (000's)	Loans 30-60 Days Past Due	Loans 61-89 Days Past Due	Loans 90 or More Days Past Due	Total Past Due Loans	Current Loans	Total Loans	Accruing Loans 90 or More Days Past Due
Commercial and Business Loans	$ 154	$ 191	$ 3,552	$ 3,897	$ 159,545	$ 163,442	$ 0
Government Program Loans	0	0	433	433	2,551	2,984	74
Total Commercial and Industrial	154	191	3,985	4,330	162,096	166,426	74
Commercial Real Estate Loans	1,248	2,514	0	3,762	115,095	118,857	0
Residential Mortgages	328	0	0	328	23,703	24,031	0
Home Improvement and Home Equity Loans	62	132	0	194	1,665	1,859	0
Total Real Estate Mortgage	1,638	2,646	0	4,284	140,463	144,747	0
Total RE Construction and Development Loans	0	0	6,150	6,150	44,250	50,400	0
Total Agricultural Loans	0	0	0	0	35,811	35,811	0
Consumer Loans	297	0	0	297	10,776	11,073	0
Overdraft protection Lines	0	0	0	0	85	85	0
Overdrafts	0	0	0	0	124	124	0
Total Installment	297	0	0	297	10,985	11,282	0
Commercial Lease Financing	0	0	0	0	49	49	0
Total Loans	$ 2,089	$ 2,837	$ 10,135	$ 15,061	$ 393,654	$ 408,715	$ 74

Nonaccrual Loans

Commercial, construction and commercial real estate loans are placed on non-accrual status under the following circumstances:

-When there is doubt regarding the full repayment of interest and principal.

-When principal and/or interest on the loan has been in default for a period of 90-days or more, unless the asset is both well secured and in the process of collection that will result in repayment in the near future.

Table of Contents

-When the loan is identified as having loss elements and/or is risk rated "8" Doubtful.

-Other circumstances which jeopardize the ultimate collectability of the loan including certain troubled debt restructurings, identified loan impairment, and certain loans to facilitate the sale of OREO.

Loans meeting any of the preceding criteria are placed on non-accrual status and the accrual of interest for financial statement purposes is discontinued. Previously accrued but unpaid interest is reversed and charged against interest income.

Loans that are secured by one-to-four family residential properties (e.g., residential mortgage loans and home equity loans) on which principal and/or interest is due and unpaid for 90 days or more are placed on non-accrual and the accrual of interest for financial statement purposes is discontinued. Previously accrued but unpaid interest is reversed and charged against interest income.

Consumer loans to individuals for personal, family and household purposes, and unsecured or secured personal property where principal or interest is due and unpaid for 90 days or more are placed on non-accrual and the accrual of interest for financial statement purposes is discontinued. Previously accrued but unpaid interest is reversed and charged against interest income.

When a loan is placed on non-accrual status and subsequent payments of interest (and principal) are received, the interest received may be accounted for in two separate ways:

Cost recovery method: If the loan is in doubt as to full collection, the interest received in subsequent payments is diverted from interest income to a valuation reserve and treated as a reduction of principal for financial reporting purposes.

Cash basis: This method is only used if the recorded investment or total contractual amount is expected to be fully collectible, under which circumstances the subsequent payments of interest is credited to interest income as received.

Loans on non-accrual status are usually not returned to accrual status unless all delinquent principal and/or interest has been brought current, there is no identified element of loss, and current and continued satisfactory performance is expected (loss of the contractual amount not the carrying amount of the loan). Repayment ability is generally demonstrated through the timely receipt of at least six monthly payments on a loan with monthly amortization.

Nonaccrual loans totaled $18.2 million and $18.1 million at June 30, 2012 and December 31, 2011, respectively. There were no remaining undisbursed commitments to extend credit on nonaccrual loans at June 30, 2012 or December 31, 2011.
The following is a summary of nonaccrual loan balances at June 30, 2012 and December 31, 2011.

	June 30, 2012	December 31, 2011
Commercial and Business Loans	$ 8,385	$ 4,722
Government Program Loans	107	358
Total Commercial and Industrial	8,492	5,080
Commercial Real Estate Loans	3,771	3,946
Residential Mortgages	37	43
Home Improvement and Home Equity Loans	111	0

Total Real Estate Mortgage	3,919	3,989
Total RE Construction and Development Loans	4,679	9,014
Total Agricultural Loans	661	0
Consumer Loans	438	15
Overdraft protection Lines	0	0
Overdrafts	0	0
Total Installment	438	15
Commercial lease Financing	0	0
Total Loans	$ 18,189	$ 18,098

Table of Contents

Impaired Loans

A loan is considered impaired when based on current information and events, it is probable that the Company will be unable to collect all amounts due, including principal and interest, according to the contractual terms of the loan agreement.

The Company applies its normal loan review procedures in making judgments regarding probable losses and loan impairment. The Company evaluates for impairment those loans on non-accrual status, graded doubtful, graded substandard or those that are troubled debt restructures. The primary basis for inclusion in impaired status under generally accepted accounting pronouncements is that it is probable that the Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement.

A loan is not considered impaired if:

- There is merely an insignificant delay or shortfall in the amounts of payments.
- The Company expects to collect all amounts due, including interest accrued, at the contractual interest rate for the period of the delay.

Review for impairment does not include large groups of smaller balance homogeneous loans that are collectively evaluated to estimate the allowance for loan losses. The Company's present allowance for loan losses methodology, including migration analysis, captures required reserves for these loans in the formula allowance.

For loans determined to be impaired, the Company evaluates impairment based upon either the fair value of underlying collateral, discounted cash flows of expected payments, or observable market price.

- For loans secured by collateral including real estate and equipment the fair value of the collateral less selling costs will determine the carrying value of the loan. The difference between the recorded investment in the loan and the fair value, less selling costs, determines the amount of impairment. The Company uses the measurement method based on fair value of collateral when the loan is collateral dependent and foreclosure is probable.
- The discounted cash flow method of measuring the impairment of a loan is used for unsecured loans or for loans secured by collateral where the fair value cannot be easily determined. Under this method, the Company assesses both the amount and timing of cash flows expected from impaired loans. The estimated cash flows are discounted using the loan's effective interest rate. The difference between the amount of the loan on the Bank's books and the discounted cash flow amounts determines the amount of impairment to be provided. This method is used for most of the Company's troubled debt restructurings or other impaired loans where some payment stream is being collected.
- The observable market price method of measuring the impairment of a loan is only used by the Company when the sale of loans or a loan is in process.

The method for recognizing interest income on impaired loans is dependent on whether the loan is on nonaccrual status or is a troubled debt restructuring. For income recognition, the existing nonaccrual and troubled debt restructuring policies are applied to impaired loans. Generally, except for certain troubled debt restructurings which are performing under the restructure agreement, the Company does not recognize interest income received on impaired loans, but reduces the carrying amount of the loan for financial reporting purposes.

Loans other than certain homogenous loan portfolios are reviewed on a quarterly basis for impairment. Impaired loans are written down to estimated realizable values by the establishment of specific reserves or charge-offs when required.

Table of Contents

The following is a summary of impaired loans at June 30, 2012.

June 30, 2012 (000's)	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment
Commercial and Business Loans	$ 9,929	$ 7,559	$ 2,240	$ 9,799	$ 166	$ 7,586
Government Program Loans	465	107	0	107	0	181
Total Commercial and Industrial	10,394	7,666	2,240	9,906	166	7,767
Commercial Real Estate Term Loans	7,971	2,780	4,922	7,702	517	7,937
Single Family Residential Loans	3,863	654	3,172	3,826	153	3,623
Home Improvement and Home Equity Loans	12	12	0	12	0	$ 28
Total Real Estate Mortgage	11,846	3,446	8,094	11,540	670	11,588
Total RE Construction and Development Loans	6,253	6,148	0	6,148	0	9,700
Total Agricultural Loans	999	719	0	719	0	1,524
Consumer Loans	92	89	0	89	0	127
Overdraft protection Lines	0	0	0	0	0	$ 0
Overdrafts	0	0	0	0	0	$ 0
Total Installment/other	92	89	0	89	0	127
Commercial Lease Financing	0	0	0	0	0	0
Total Impaired Loans	$ 29,584	$ 18,068	$ 10,334	$ 28,402	$ 836	$ 30,706

The following is a summary of impaired loans at December 31, 2011.

December 31, 2011 (000's)	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment
Commercial and Business Loans	$ 6,521	$ 4,002	$ 2,425	$ 6,427	$ 112	$ 11,102
Government Program Loans	704	212	0	212	0	301
	7,225	4,214	2,425	6,639	112	11,403

Total Commercial and Industrial						
Commercial Real Estate Loans	8,457	4,209	4,094	8,303	523	7,258
Residential Mortgages	3,569	494	3,037	3,531	166	3,619
Home Improvement and Home Equity Loans	36	22	15	37	1	96
Total Real Estate Mortgage	12,062	4,725	7,146	11,871	690	10,973
Total RE Construction and Development Loans	11,535	9,014	2,418	11,432	71	17,184
Total Agricultural Loans	2,445	61	1,792	1,853	381	2,139
Consumer Loans	88	87	0	87	0	184
Overdraft protection Lines	0	0	0	0	0	0
Overdrafts	0	0	0	0	0	0
Total Installment	88	87	0	87	0	184
Commercial Lease Financing	0	0	0	0	0	55
Total Impaired Loans	$ 33,355	$ 18,101	$ 13,781	$ 31,882	$ 1,254	$ 41,938

In most cases, the Company uses the cash basis method of income recognition for impaired loans. In the case of certain troubled debt restructurings for which the loan is performing under the current contractual terms for a reasonable period of time, income is recognized under the accrual method.

The average recorded investment in impaired loans for the quarter ended June 30, 2011 and June 2012 was $45.9 million and $30.1 million, while the average recorded investment in impaired loans for the six months ended June 30, 2011 and June 2012 was $47.6 million and $30.7 million, respectively.

Interest income recognized on impaired loans for the quarters ended June 30, 2012 and 2011 was approximately $127,000 and $156, respectively. Interest income recognized on impaired loans during the six months ended June 30, 2012 and 2011 was approximately $253,000 and $312,000, respectively.

Table of Contents

Troubled Debt Restructurings

Under the circumstances, when the Company grants a concession to a borrower as part of a loan restructuring, the restructuring is accounted for as a troubled debt restructuring (TDR). TDRs are reported as a component of impaired loans.

A TDR is a type of restructuring in which the Company, for economic or legal reasons related to the borrower's financial difficulties, grants a concession (either imposed by court order, law, or agreement between the borrower and the Bank) to the borrower that it would not otherwise consider. Although the restructuring may take different forms, the Company's objective is to maximize recovery of its investment by granting relief to the borrower.

A TDR may include, but is not limited to, one or more of the following:

- A transfer from the borrower to the Company of receivables from third parties, real estate, other assets, or an equity interest in the borrower is granted to fully or partially satisfy the loan.
- A modification of terms of a debt such as one or a combination of:
  - o The reduction (absolute or contingent) of the stated interest rate.
  - o The extension of the maturity date or dates at a stated interest rate lower than the current market rate for new debt with similar risk.
  - o The reduction (absolute or contingent) of the face amount or maturity amount of the debt as stated in the instrument or agreement.
  - o The reduction (absolute or contingent) of accrued interest.

For a restructured loan to return to accrual status there needs to be, among other factors, at least 6 months successful payment history. In addition, the Company performs a financial analysis of the credit to determine whether the borrower has the ability to continue to meet payments over the remaining life of the loan. This includes, but is not limited to, a review of financial statements and cash flow analysis of the borrower. Only after determination that the borrower has the ability to perform under the terms of the loans, will the restructured credit be considered for accrual status.

The following table illustrates TDR activity for the periods indicated:

	Six Months Ended June 30, 2012		
Troubled Debt Restructurings	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial and Business Loans	0	$ 0	$ 0
Government Program Loans	0	0	0

Commercial Real Estate Term Loans	5	1,330	1,321
Single Family Residential Loans	0	0	0
Home Improvement and Home Equity Loans	0	0	0
RE Construction and Development Loans	0	0	0
Agricultural Loans	0	0	0
Consumer Loans	0	0	0
Overdraft protection Lines	0	0	0
Commercial Lease Financing	0	0	0
Total Loans	5	$ 1,330	$ 1,321

Table of Contents

Troubled Debt Restructurings that Defaulted	Six Months Ended June 30, 2012	
	Number of Contracts	Recorded Investment
Commercial and Business Loans	0	$ 0
Government Program Loans	0	0
Commercial Real Estate Term Loans	0	0
Single Family Residential Loans	0	0
Home Improvement and Home Equity Loans	0	0
RE Construction and Development Loans	0	0
Agricultural Loans	0	0
Consumer Loans	0	0
Overdraft protection Lines	0	0
Commercial Lease Financing	0	0
Total Loans	0	$ 0

Troubled Debt Restructurings	Three Months Ended June 30, 2012		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial and Business Loans	0	$ 0	$ 0
Government Program Loans	0	0	0
Commercial Real Estate Term Loans	1	20	20
Single Family Residential Loans	0	0	0
Home Improvement and Home Equity Loans	0	0	0
RE Construction and Development Loans	0	0	0
Agricultural Loans	0	0	0
Consumer Loans	0	0	0
Overdraft protection Lines	0	0	0
Commercial Lease Financing	0	0	0
Total Loans	1	$ 20	$ 20

Table of Contents

Troubled Debt Restructurings that Defaulted	Three Months Ended June 30, 2012	
	Number of Contracts	Recorded Investment
Commercial and Business Loans	0	$ 0
Government Program Loans	0	0
Commercial Real Estate Term Loans	0	0
Single Family Residential Loans	0	0
Home Improvement and Home Equity Loans	0	0
RE Construction and Development Loans	0	0
Agricultural Loans	0	0
Consumer Loans	0	0
Overdraft protection Lines	0	0
Commercial Lease Financing	0	0
Total Loans	0	$ 0

The Company makes various types of concessions when structuring TDRs including rate reductions, payment extensions, and forbearance. At June 30, 2012, the Company had 42 restructured loans totaling $16.8 million as compared to 41 restructured loans totaling $19.0 million at December 31, 2011.

Credit Quality Indicators

As part of its credit monitoring program, the Company utilizes a risk rating system which quantifies the risk the Company estimates it has assumed during the life of a loan. The system rates the strength of the borrower and the facility or transaction, and is designed to provide a program for risk management and early detection of problems.

For each new credit approval, credit extension, renewal, or modification of existing credit facilities, the Company assigns risk ratings utilizing the rating scale identified in this policy. In addition, on an on-going basis, loans and credit facilities are reviewed for internal and external influences impacting the credit facility that would warrant a change in the risk rating. Each loan credit facility is to be given a risk rating that takes into account factors that materially affect credit quality.

When assigning risk ratings, the Company evaluates two risk rating approaches, a facility rating and a borrower rating as follows:

Facility Rating:

The facility rating is determined by the analysis of positive and negative factors that may indicate that the quality of a particular loan or credit arrangement requires that it be rated differently from the risk rating assigned to the borrower. The Company assesses the risk impact of these factors:

Collateral - The rating may be affected by the type and quality of the collateral, the degree of coverage, the economic life of the collateral, liquidation value and the Company's ability to dispose of the collateral.

Guarantees - The value of third party support arrangements varies widely. Unconditional guaranties from persons with demonstrable ability to perform are more substantial than that of closely related persons to the borrower who offer

only modest support.

Unusual Terms - Credit may be extended on terms that subject the Company to a higher level of risk than indicated in the rating of the borrower.

Borrower Rating:

The borrower rating is a measure of loss possibility based on the historical, current and anticipated financial characteristics of the borrower in the current risk environment. To determine the rating, the Company considers at least the following factors:

-Quality of management
-Liquidity
-Leverage/capitalization
-Profit margins/earnings trend
-Adequacy of financial records
-Alternative funding sources

-Geographic risk
-Industry risk
-Cash flow risk
-Accounting practices
-Asset protection
-Extraordinary risks

The Company assigns risk ratings to loans other than consumer loans and other homogeneous loan pools based on the following scale. The risk ratings are used when determining borrower ratings as well as facility ratings. When the borrower rating and the facility ratings differ, the lowest rating applied is:

-Grades 1 and 2 – These grades include loans which are given to high quality borrowers with high credit quality and sound financial strength. Key financial ratios are generally above industry averages and the borrower's strong earnings history or net worth. These may be secured by deposit accounts or high-grade investment securities.

-Grade 3 – This grade includes loans to borrowers with solid credit quality with minimal risk. The borrower's balance sheet and financial ratios are generally in line with industry averages, and the borrower has historically demonstrated the ability to manage economic adversity. Real estate and asset-based loans assigned this risk rating must have characteristics, which place them well above the minimum underwriting requirements for those departments. Asset-based borrowers assigned this rating must exhibit extremely favorable leverage and cash flow characteristics, and consistently demonstrate a high level of unused borrowing capacity.

-Grades 4 and 5 – These include "pass" grade loans to borrowers of acceptable credit quality and risk. The borrower's balance sheet and financial ratios may be below industry averages, but above the lowest industry quartile. Leverage is above and liquidity is below industry averages. Inadequacies evident in financial performance and/or management sufficiency are offset by readily available features of support, such as adequate collateral, or good guarantors having the liquid assets and/or cash flow capacity to repay the debt. The borrower may have recognized a loss over three or four years, however recent earnings trends, while perhaps somewhat cyclical, are improving and cash flows are adequate to cover debt service and fixed obligations. Real estate and asset-borrowers fully comply with all underwriting standards and are performing according to projections would be assigned this rating. These also include grade 5 loans which are "leveraged" or on management's "watch list." While still considered pass loans (loans given a grade 5), the borrower's financial condition, cash flow or operations evidence more than average risk and short term weaknesses , these loans warrant a higher than average level of monitoring, supervision and attention from the Company, but do not reflect credit weakness trends that weaken or inadequately protect the Company's credit position. Loans with a grade rating of 5 are not normally acceptable as new credits unless they are adequately secured or carry substantial endorser/guarantors.

-Grade 6 – This grade includes "special mention" loans which are loans that are currently protected but are potentially weak. This generally is an interim grade classification and should usually be upgraded to an Acceptable rating or downgraded to Substandard within a reasonable time period. Weaknesses in special mention loans may, if not checked or corrected, weaken the asset or inadequately protect the Company's credit position at some future date. Special mention loans are often loans with weaknesses inherent from the loan origination, loan servicing, and perhaps some technical deficiencies. The main theme in special mention credits is the distinct probability that the classification will deteriorate to a more adverse class if the noted deficiencies are not addressed by the loan officer or loan management.

-Grade 7 – This grade includes "substandard" loans which are inadequately supported by the current sound net worth and paying capacity of the borrower or of the collateral pledged, if any. Substandard loans have a well-defined weakness or weaknesses that may impair the regular liquidation of the debt. Substandard loans exhibit a distinct

possibility that the Company will sustain some loss if the deficiencies are not corrected. Substandard loans also include impaired loans.

- Grade 8 - This grade includes “doubtful” loans which exhibit the same characteristics as the Substandard loans with 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 certain important and reasonably specific pending factors, which may work to the advantage and strengthening of the loan, its classification as an estimated loss is deferred until its more exact status may be determined. Pending factors include a proposed merger, acquisition, or liquidation procedures, capital injection, perfecting liens on additional collateral and refinancing plans.

- Grade 9 - This grade includes loans classified “loss” which are considered uncollectible and of such little value that their continuance as bankable assets 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 the asset even though partial recovery may be achieved in the future.

Table of Contents

The Company did not carry any loans graded as loss at June 30, 2012 or December 31, 2011.

The following tables summarize the credit risk ratings for commercial, construction, and other non-consumer related loans for June 30, 2012 and December 31, 2011:

June 30, 2012 (000's)	Commercial and Lease Financing	Commercial RE	RE Construction and Development	Agricultural	Total
Grades 1and 2	$ 456	$ 0	$ 0	$ 0	$ 456
Grade 3	1,656	6,895	876	0	9,427
Grades 4 and 5 – pass	122,358	118,276	32,899	28,296	301,829
Grade 6 – special mention	10,452	919	0	0	11,371
Grade 7 – substandard	8,765	6,422	16,858	661	32,706
Grade 8 – doubtful	0	0	0	0	0
Total	$ 143,687	$ 132,512	$ 50,633	$ 28,957	$ 355,789

December 31, 2011 (000's)	Commercial and Lease Financing	Commercial RE	RE Construction and Development	Agricultural	Total
Grades 1and 2	$ 725	$ 0	$ 0	$ 40	$ 765
Grade 3	184	7,026	897	0	8,107
Grades 4 and 5 – pass	149,815	104,468	28,596	33,990	316,869
Grade 6 – special mention	10,431	749	0	0	11,180
Grade 7 – substandard	5,320	6,614	20,907	1,781	34,622
Grade 8 – doubtful					
Total	$ 166,475	$ 118,857	$ 50,400	$ 35,811	$ 371,543

The Company follows consistent underwriting standards outlined in its loan policy for consumer and other homogenous loans but, does not specifically assign a risk rating when these loans are originated. Consumer loans are monitored for credit risk and are considered “pass” loans until some issue or event requires that the credit be downgraded to special mention or worse.

The following tables summarize the credit risk ratings for consumer related loans and other homogenous loans for June 30, 2012 and December 31, 2011:

	June 30, 2012				December 31, 2011			
(000's)	Single family Residential	Home Improvement and Home Equity	Installment	Total	Single family Residential	Home Improvement and Home Equity	Installment	Total
Not graded	$ 19,690	$ 1,748	$ 9,771	$ 31,209	$ 18,858	$ 1,801	$ 9,615	$ 30,274
Pass	5,358	21	1,779	7,158	4,796	22	1,163	5,981
Special Mention	0	0	47	47	0	0	423	423

Substandard	368	12	498	878	377	36	81	494
Total	$ 25,416	$ 1,781	$ 12,095	$ 39,292	$ 24,031	$ 1,859	$ 11,282	$ 37,172

Allowance for Loan Losses

The Company analyzes risk characteristics inherent in each loan portfolio segment as part of the quarterly review of the adequacy of the allowance for loan losses. The following summarizes some of the key risk characteristics for the eleven segments of the loan portfolio (Consumer loans include three segments):

21

Table of Contents

Commercial and business loans – Commercial loans are subject to the effects of economic cycles and tend to exhibit increased risk as economic conditions deteriorate, or if the economic downturn is prolonged. The Company considers this segment to be one of higher risk given the size of individual loans and the balances in the overall portfolio.

Government program loans – This is a relatively a small part of the Company's loan portfolio, but has historically had a high percentage of loans that have migrated from pass to substandard given there vulnerability to economic cycles.

Commercial real estate loans – This segment is considered to have more risk in part because of the vulnerability of commercial businesses to economic cycles as well as the exposure to fluctuations in real estate prices because most of these loans are secured by real estate. Losses in this segment have however been historically low because most of the loans are real estate secured.

Single family residential loans – This segment is considered to have low risk factors both from the Company and peer statistics. These loans are secured by first deeds of trust. The losses experienced over the past twelve quarters are isolated to approximately seven loans and are generally the result of short sales.

Home improvement and home equity loans – Because of their junior lien position, these loans have an inherently higher risk level. Because residential real estate has been severely distressed in the recent past, the anticipated risk for this loan segment has increased.

Real estate construction loans –In a normal economy, this segment of loans is considered to have a higher risk profile due to construction and market value issues in conjunction with normal credit risks. In the current distressed residential real estate markets the risk has increased.

Agricultural loans – This segment is considered to have risks associated with weather, insects, and marketing issues. In addition, concentrations in certain crops or certain agricultural areas can increase risk.

Consumer loans (includes consumer loans, overdrafts, and overdraft protection lines) – This segment is higher risk because many of the loans are unsecured.

Commercial lease financing – This segment of the portfolio is small, but is considered to be vulnerable to economic cycles given the nature of the leasing relationship where businesses are relatively small or have minimal cash flow. This lending program was terminated in 2005.

The following summarizes the activity in the allowance for credit losses by loan category for the six and three months ended June 30, 2012.

Six Months Ended June 30, 2012 (in 000's)	Commercial and Industrial	Real Estate Mortgage	RE Construction Development	Agricultural	Installment & Other	Commercial Lease Financing	Unallocated	Total
Beginning balance	$ 6,787	$ 1,416	$ 4,579	$ 508	$ 116	$ 1	$ 241	$ 13,648
Provision for credit losses	(2,521)	(313)	1,231	1,938	344	2	325	1,006
Charge-offs	(763)	(53)	(10)	(2,169)	(137)	0	0	(3,132)
Recoveries	61	4	0	0	23	0	0	88

Net charge-offs	(702)	(49)	(10)	(2,169)	(114)	0	0	(3,044)
Ending balance	$ 3,564	$ 1,054	$ 5,800	$ 277	$ 346	$ 3	$ 566	$ 11,610
Period-end amount allocated to:								
Loans individually evaluated for impairment	$ 166	$ 670	$ 0	$ 0	$ 0	$ 0	$ 0	$ 836
Loans collectively evaluated for impairment	3,398	384	5,800	277	346	3	566	10,774
Ending balance	$ 3,564	$ 1,054	$ 5,800	$ 277	$ 346	$ 3	$ 566	$ 11,610

Table of Contents

Three Months Ended June 30, 2012 (in 000's)	Commercial and Industrial	Real Estate Mortgage	RE Construction Development	Agricultural	Installment & Other	Commercial Lease Financing	Unallocated	Total
Beginning balance	$ 5,220	$ 1,472	$ 4,523	$ 1,116	$ 87	$ 1	$ 631	$ 13,050
Provision for credit losses	(1,533)	(401)	1,287	1,330	384	2	(65)	1,004
Charge-offs	(146)	(20)	(10)	(2,169)	(135)	0	0	(2,480)
Recoveries	23	3	0	0	10	0	0	36
Net charge-offs	(123)	(17)	(10)	(2,169)	(125)	0	0	(2,444)
Ending balance	$ 3,564	$ 1,054	$ 5,800	$ 277	$ 346	$ 3	$ 566	$ 11,610
Period-end amount allocated to:								
Loans individually evaluated for impairment	$ 166	$ 670	$ 0	$ 0	$ 0	$ 0	$ 0	$ 836
Loans collectively evaluated for impairment	3,398	384	5,800	277	346	3	566	10,774
Ending balance	$ 3,564	$ 1,054	$ 5,800	$ 277	$ 346	$ 3	$ 566	$ 11,610

The following summarizes the activity in the allowance for credit losses by loan category for the six and three months ended June 30, 2011.

Six Months Ended June 30, 2011 (in 000's) (As Restated)	Commercial and Industrial	Real Estate Mortgage	RE Construction Development	Agricultural	Installment & Other	Commercial Lease Financing	Unallocated	Total
Beginning balance	$ 8,209	$ 1,620	$ 5,763	$ 850	$ 49	$ 3	$ 26	$ 16,520
Provision for credit losses	5,791	281	3,966	(100)	36	103	(26)	10,051
Charge-offs	(6,897)	(406)	(5,480)	(537)	(20)	(100)		(13,440)
Recoveries	72	0	607	66	3	0		748
Net charge-offs	(6,825)	(406)	(4,873)	(471)	(17)	(100)	0	(12,692)

Ending balance	$ 7,175	$ 1,495	$ 4,856	$ 279	$ 68	$ 6	$ 0	$ 13,879
Period-end amount allocated to:								
Loans individually evaluated for impairment	$ 652	$ 467	$ 978	$ 149	$ 23	$ 0	$ 0	$ 2,269
Loans collectively evaluated for impairment	6,523	1,028	3,878	130	45	6	0	11,610
Ending balance	$ 7,175	$ 1,495	$ 4,856	$ 279	$ 68	$ 6	$ 0	$ 13,879

Three Months Ended June 30, 2011 (in 000's) (As Restated)	Commercial and Industrial	Real Estate Mortgage	RE Construction Development	Agricultural	Installment & Other	Commercial Lease Financing	Unallocated	Total
Beginning balance	8,337	$ 1,574	$ 6,059	$ 381	$ 80	$ 24	$ 290	$ 16,745
Provision for credit losses	5,621	300	3,668	(147)	5	4	(290)	9,161
Charge-offs	(6,826)	(379)	(5,478)	(1)	(18)	(22)	0	(12,724)
Recoveries	43	0	607	46	1	0	0	697
Net charge-offs	(6,783)	(379)	(4,871)	45	(17)	(22)	0	(12,027)
Ending balance	$ 7,175	$ 1,495	$ 4,856	$ 279	$ 68	$ 6	$ 0	$ 13,879
Period-end amount allocated to:								
Loans individually evaluated for impairment	$ 652	$ 467	$ 978	$ 149	$ 23	$ 0	$ 0	$ 2,269
Loans collectively evaluated for impairment	6,523	1,028	3,878	130	45	6	0	11,610
Ending balance	$ 7,175	$ 1,495	$ 4,856	$ 279	$ 68	$ 6	$ 0	$ 13,879

Table of Contents

The following summarizes information with respect to the loan balances at June 30, 2012 and December 31, 2011.

	June 30, 2012			December 31, 2011		
(000's)	Loans Individually Evaluated for Impairment	Loans Collectively Evaluated for Impairment	Total Loans	Loans Individually Evaluated for Impairment	Loans Collectively Evaluated for Impairment	Total Loans
Commercial and Business Loans	$ 9,799	$ 131,358	$ 141,157	$ 6,427	$ 157,015	$ 163,442
Government Program Loans	107	$ 2,393	2,500	212	2,772	2,984
Total Commercial and Industrial	9,906	$ 133,751	143,657	6,639	159,787	166,426
Commercial Real Estate Loans	7,702	$ 124,810	132,512	8,303	110,554	118,857
Residential Mortgage Loans	3,826	$ 21,590	25,416	3,531	20,500	24,031
Home Improvement and Home Equity Loans	12	$ 1,769	1,781	37	1822	1,859
Total Real Estate Mortgage	11,540	$ 148,169	159,709	11,871	132,876	144,747
Total RE Construction and Development Loans	6,148	$ 44,485	50,633	11,432	38,968	50,400
Total Agricultural Loans	719	$ 28,238	28,957	1,853	33,958	35,811
Total Installment Loans	89	$ 12,006	12,095	87	11,195	11,282
Commercial Lease Financing	0	$ 30	30	0	49	49
Total Loans	$ 28,402	$ 366,679	$ 395,081	$ 31,882	$ 376,833	$ 408,715

4.Deposits