MGM MIRAGE
Form SC 13D/A
December 15, 2008

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

SCHEDULE 13D/A

Under Rule 13d-1 of the Securities Exchange Act of 1934

(Amendment No. 7)

MGM MIRAGE

(Name of Issuer)

Common Stock, par value $.01 per share

(Title of Class of Securities)

552953101

(CUSIP Number)

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515 South Flower Street

Los Angeles, California 90071

(Name, Address and Telephone Number of Person Authorized to Receive Notices and Communications)

December 10, 2008

(Date of Event which Requires Filing of this Statement)

If the filing person has previously filed a statement on Schedule 13G to report the acquisition that is the subject of this Schedule 13D, and is filing this schedule because of §§240.13d-1(e), 240.13d-1(f) or 240.13d-1(g), check the following box ¨.

* The remainder of this cover page shall be filled out for a reporting person s initial filing on this form with respect to the subject class of securities, and for any subsequent amendment containing information which would alter disclosures provided in a prior cover page.

The information required on the remainder of this cover page shall not be deemed to be filed for the purpose of Section 18 of the Securities Exchange Act of 1934 (Act) or otherwise subject to the liabilities of that section of the Act but shall be subject to all other provisions of the Act (however, see the Notes).

CUSIP No. 552953101

1 NAME OF REPORTING PERSON

I.R.S. IDENTIFICATION NO. OF ABOVE PERSON

Infinity World Investments LLC

2 CHECK THE APPROPRIATE BOX IF A MEMBER OF A GROUP

(a) x

(b) ¨

3 SEC USE ONLY

4 SOURCE OF FUNDS

AF

5 CHECK BOX IF DISCLOSURE OF LEGAL PROCEEDINGS IS REQUIRED PURSUANT TO ITEMS 2(d) OR 2(e)

¨

6 CITIZENSHIP OR PLACE OF ORGANIZATION

Nevada

NUMBER OF SHARES BENEFICIALLY OWNED BY EACH REPORTING PERSON WITH	7	SOLE VOTING POWER 14,548,738 shares
	8	SHARED VOTING POWER -0- shares
	9	SOLE DISPOSITIVE POWER 14,548,738 shares
	10	SHARED DISPOSITIVE POWER

-0- shares

11 AGGREGATE AMOUNT BENEFICIALLY OWNED BY EACH REPORTING PERSON

14,548,738 shares

12 CHECK BOX IF THE AGGREGATE AMOUNT IN ROW (11) EXCLUDES SHARES

..

13 PERCENT OF CLASS REPRESENTED BY AMOUNT IN ROW (11)

5.3%[1]

14 TYPE OF REPORTING PERSON

CO

[1] This calculation is based upon the total number of 276,502,614 outstanding shares of common stock, par value $.01 per share, as of November 3, 2008, as reported in MGM MIRAGE s Quarterly Report on Form 10-Q for the quarter ended September 30, 2008.

CUSIP No. 552953101

1 NAME OF REPORTING PERSON

I.R.S. IDENTIFICATION NO. OF ABOVE PERSON

Infinity World Cayman Investments Corporation

2 CHECK THE APPROPRIATE BOX IF A MEMBER OF A GROUP

(a) x

(b) ¨

3 SEC USE ONLY

4 SOURCE OF FUNDS

AF

5 CHECK BOX IF DISCLOSURE OF LEGAL PROCEEDINGS IS REQUIRED PURSUANT TO ITEMS 2(d) OR 2(e)

¨

6 CITIZENSHIP OR PLACE OF ORGANIZATION

Cayman Islands

NUMBER OF SHARES BENEFICIALLY OWNED BY EACH REPORTING PERSON WITH	7	SOLE VOTING POWER 14,548,738 shares
	8	SHARED VOTING POWER -0- shares
	9	SOLE DISPOSITIVE POWER 14,548,738 shares
	10	SHARED DISPOSITIVE POWER

-0- shares

11 AGGREGATE AMOUNT BENEFICIALLY OWNED BY EACH REPORTING PERSON

14,548,738 shares

12 CHECK BOX IF THE AGGREGATE AMOUNT IN ROW (11) EXCLUDES SHARES

..

13 PERCENT OF CLASS REPRESENTED BY AMOUNT IN ROW (11)

5.3%[2]

14 TYPE OF REPORTING PERSON

CO

[2] This calculation is based upon the total number of 276,502,614 outstanding shares of common stock, par value $.01 per share, as of November 3, 2008, as reported in MGM MIRAGE s Quarterly Report on Form 10-Q for the quarter ended September 30, 2008.

CUSIP No. 552953101

1 NAME OF REPORTING PERSON

I.R.S. IDENTIFICATION NO. OF ABOVE PERSON

Infinity World (Cayman) L.P.

2 CHECK THE APPROPRIATE BOX IF A MEMBER OF A GROUP

(a) x

(b) ¨

3 SEC USE ONLY

4 SOURCE OF FUNDS

AF

5 CHECK BOX IF DISCLOSURE OF LEGAL PROCEEDINGS IS REQUIRED PURSUANT TO ITEMS 2(d) OR 2(e)

¨

6 CITIZENSHIP OR PLACE OF ORGANIZATION

Cayman Islands

NUMBER OF SHARES BENEFICIALLY OWNED BY EACH REPORTING PERSON WITH	7	SOLE VOTING POWER 26,048,738 shares
	8	SHARED VOTING POWER -0- shares
	9	SOLE DISPOSITIVE POWER 26,048,738 shares
	10	SHARED DISPOSITIVE POWER

-0- shares

11 AGGREGATE AMOUNT BENEFICIALLY OWNED BY EACH REPORTING PERSON

26,048,738 shares

12 CHECK BOX IF THE AGGREGATE AMOUNT IN ROW (11) EXCLUDES SHARES

..

13 PERCENT OF CLASS REPRESENTED BY AMOUNT IN ROW (11)

9.4%[3]

14 TYPE OF REPORTING PERSON

PN

[3] This calculation is based upon the total number of 276,502,614 outstanding shares of common stock, par value $.01 per share, as of November 3, 2008, as reported in MGM MIRAGE s Quarterly Report on Form 10-Q for the quarter ended September 30, 2008.

CUSIP No. 552953101

1 NAME OF REPORTING PERSON

I.R.S. IDENTIFICATION NO. OF ABOVE PERSON

Infinity World (Cayman) Holding

2 CHECK THE APPROPRIATE BOX IF A MEMBER OF A GROUP

(a) x

(b) ¨

3 SEC USE ONLY

4 SOURCE OF FUNDS

AF

5 CHECK BOX IF DISCLOSURE OF LEGAL PROCEEDINGS IS REQUIRED PURSUANT TO ITEMS 2(d) OR 2(e)

¨

6 CITIZENSHIP OR PLACE OF ORGANIZATION

Cayman Islands

NUMBER OF SHARES BENEFICIALLY OWNED BY EACH REPORTING PERSON WITH	7	SOLE VOTING POWER 26,048,738 shares
	8	SHARED VOTING POWER -0- shares
	9	SOLE DISPOSITIVE POWER 26,048,738 shares
	10	SHARED DISPOSITIVE POWER

-0- shares

11 AGGREGATE AMOUNT BENEFICIALLY OWNED BY EACH REPORTING PERSON

26,048,738 shares

12 CHECK BOX IF THE AGGREGATE AMOUNT IN ROW (11) EXCLUDES SHARES

..

13 PERCENT OF CLASS REPRESENTED BY AMOUNT IN ROW (11)

9.4%[4]

14 TYPE OF REPORTING PERSON

CO

[4] This calculation is based upon the total number of 276,502,614 outstanding shares of common stock, par value $.01 per share, as of November 3, 2008, as reported in MGM MIRAGE s Quarterly Report on Form 10-Q for the quarter ended September 30, 2008.

CUSIP No. 552953101

1 NAME OF REPORTING PERSON

I.R.S. IDENTIFICATION NO. OF ABOVE PERSON

Infinity World Holding Ltd.

2 CHECK THE APPROPRIATE BOX IF A MEMBER OF A GROUP

(a) x

(b) ¨

3 SEC USE ONLY

4 SOURCE OF FUNDS

AF

5 CHECK BOX IF DISCLOSURE OF LEGAL PROCEEDINGS IS REQUIRED PURSUANT TO ITEMS 2(d) OR 2(e)

..

6 CITIZENSHIP OR PLACE OF ORGANIZATION

Dubai, United Arab Emirates

NUMBER OF SHARES BENEFICIALLY OWNED BY EACH REPORTING PERSON WITH	7	SOLE VOTING POWER 26,048,738 shares
	8	SHARED VOTING POWER -0- shares
	9	SOLE DISPOSITIVE POWER 26,048,738 shares
	10	SHARED DISPOSITIVE POWER

-0- shares

11 AGGREGATE AMOUNT BENEFICIALLY OWNED BY EACH REPORTING PERSON

26,048,738 shares

12 CHECK BOX IF THE AGGREGATE AMOUNT IN ROW (11) EXCLUDES SHARES

..

13 PERCENT OF CLASS REPRESENTED BY AMOUNT IN ROW (11)

9.4%[5]

14 TYPE OF REPORTING PERSON

CO

[5] This calculation is based upon the total number of 276,502,614 outstanding shares of common stock, par value $.01 per share, as of November 3, 2008, as reported in MGM MIRAGE s Quarterly Report on Form 10-Q for the quarter ended September 30, 2008.

CUSIP No. 552953101

1 NAME OF REPORTING PERSON

I.R.S. IDENTIFICATION NO. OF ABOVE PERSON

Dubai World

2 CHECK THE APPROPRIATE BOX IF A MEMBER OF A GROUP

(a) x

(b) ¨

3 SEC USE ONLY

4 SOURCE OF FUNDS

WC

5 CHECK BOX IF DISCLOSURE OF LEGAL PROCEEDINGS IS REQUIRED PURSUANT TO ITEMS 2(d) OR 2(e)

..

6 CITIZENSHIP OR PLACE OF ORGANIZATION

Dubai, United Arab Emirates

NUMBER OF SHARES BENEFICIALLY OWNED BY EACH REPORTING PERSON WITH	7	SOLE VOTING POWER 26,048,738 shares
	8	SHARED VOTING POWER -0- shares
	9	SOLE DISPOSITIVE POWER 26,048,738 shares
	10	SHARED DISPOSITIVE POWER

-0- shares

11 AGGREGATE AMOUNT BENEFICIALLY OWNED BY EACH REPORTING PERSON

26,048,738 shares

12 CHECK BOX IF THE AGGREGATE AMOUNT IN ROW (11) EXCLUDES SHARES

..

13 PERCENT OF CLASS REPRESENTED BY AMOUNT IN ROW (11)

9.4%[6]

14 TYPE OF REPORTING PERSON

OO

6 This calculation is based upon the total number of 276,502,614 outstanding shares of common stock, par value $.01 per share, as of November 3, 2008, as reported in MGM MIRAGE s Quarterly Report on Form 10-Q for the quarter ended September 30, 2008.

This Schedule 13D/A constitutes Amendment No. 7 to that certain Schedule 13D filed on December 28, 2007, as previously amended by Amendment No. 1 filed on January 16, 2008, Amendment No. 2 filed on February 27, 2008, Amendment No. 3 filed on April 29, 2008, Amendment No. 4 filed on June 25, 2008, Amendment No. 5 filed on August 7, 2008, and Amendment No. 6 filed on November 7, 2008 by Infinity World Investments LLC, a Nevada limited liability company, Infinity World Cayman Investments Corporation, a Cayman Islands exempted company, Infinity World (Cayman) L.P., a Cayman Islands exempted limited partnership, Infinity World (Cayman) Holding, a Cayman Islands exempted company, Infinity World Holding Ltd., a Dubai, United Arab Emirates offshore corporation, and Dubai World, a Dubai, United Arab Emirates government decree entity (collectively, with all subsequent amendments, the Schedule 13D). Except as specifically set forth herein, the Schedule 13D remains unmodified.

Item 3. Source and Amount of Funds or Other Consideration

Item 3 is hereby amended to add the following paragraph as the last paragraph:

On December 10, 2008, Infinity World Investments LLC (Infinity World) and Infinity World (Cayman) L.P. (Cayman LP) entered into a Payoff Letter (the Letter Agreement) with each of Credit Suisse International, Deutsche Bank AG, London Branch, and The Royal Bank of Scotland plc (collectively, the Banks) and Deutsche Bank Trust Company Americas, as collateral agent (the Collateral Agent), whereby the Banks received $890,738,836.05 from Infinity World and Cayman LP on December 11, 2008 to settle in full the share forward transactions and share swap transactions among the Banks, Infinity World and Cayman LP (the Margin Facility) and released Infinity World and Cayman LP from all obligations, except for those obligations that, according to their terms, survive termination, under the Amended and Restated Pledge Agreement dated as of April 21, 2008 attached as Exhibit 39 to Amendment No. 3 to the Schedule 13D filed on April 29, 2008, and Amendment No. 1 to Pledge Agreement dated as of November 4, 2008 attached as Exhibit 50 to Amendment No. 6 to the Schedule 13D filed on November 7, 2008 and incorporated herein by reference (collectively, the Amended Pledge Agreement), and each Bank also released Infinity World and Cayman LP from all obligations, except for those obligations that, according to their terms, survive termination, under the Amended and Restated Confirmations dated April 21, 2008 attached as Exhibits 36, 37 and 38 to Amendment No. 3 to the Schedule 13D filed on April 29, 2008, the Second Amendment to Confirmations dated June 23, 2008 attached as Exhibits 42, 43 and 44 to Amendment No. 4 to the Schedule 13D filed on June 25, 2008 and the Third Amendment to Confirmations dated November 4, 2008 attached as Exhibits 46, 47 and 48 to Amendment No. 6 to the Schedule 13D filed on November 7, 2008 and incorporated herein by reference (collectively, the Amended Confirmations). Pursuant to the Letter Agreement, the Banks also terminated the liens and security interests in shares of common stock of MGM MIRAGE (the Shares) owned by Infinity World and Cayman LP granted to the Banks pursuant to the Amended Pledge Agreement. Pursuant to the Letter Agreement, the Banks released Dubai World, Infinity World and Cayman LP from all obligations, except for those obligations that, according to their terms, survive termination, under the Second Amended and Restated Liquidity Agreement dated as of August 7, 2008 attached as Exhibit 40 to Amendment No. 5 to the Schedule 13D filed on August 15, 2008 and incorporated herein by reference (the Amended Liquidity Agreement), and each Bank also released Dubai World from all obligations, except for those obligations that, according to their terms, survive termination, under the Guarantee dated as of November 4, 2008 attached as Exhibit 49 to Amendment No. 6 to the Schedule 13D filed on November 7, 2008 and incorporated herein by reference (the Guarantee). This summary of the Letter Agreement is not intended to be complete and is qualified in its entirety by reference to the Letter Agreement incorporated herein by reference as Exhibit 51.

Item 6. Contracts, Arrangements, Understandings or Relationships with Respect to Securities of the Issuer

Item 6 is hereby amended to add the following paragraph as the last paragraph:

On December 10, 2008, Infinity World and Cayman LP entered into the Letter Agreement described in Item 3 above with the Banks and the Collateral Agent, whereby, among other things, the Banks received $890,738,836.05 from Infinity World and Cayman LP on December 11, 2008 to settle in full the Margin Facility and released Infinity World and Cayman LP from all obligations, except for those obligations that, according to their terms, survive termination, under the Amended Pledge Agreement and the Amended Confirmations. Pursuant to the Letter Agreement, the Banks also terminated the liens and security interests in the Shares owned by Infinity World and Cayman LP granted to the Banks pursuant to the Amended Pledge Agreement. Each Bank also released Dubai World, Infinity World and Cayman LP from all obligations, except for those obligations that, according to their terms, survive termination, under the Amended Liquidity Agreement and released Dubai World from all obligations, except for those obligations that, according to their terms, survive termination, under the Guarantee. This summary of the Letter Agreement is not intended to be complete and is qualified in its entirety by reference to the Letter Agreement incorporated herein by reference as Exhibit 51.

Item 7. Material to be Filed as Exhibits

Item 7 is hereby amended to add the following exhibit:

Exhibit No.	Description of Exhibits
51	Payoff Letter dated as of December 10, 2008 by and among Credit Suisse International, Deutsche Bank AG, London Branch, The Royal Bank of Scotland plc, Deutsche Bank Trust Company Americas, as Collateral Agent, Infinity World (Cayman) L.P. and Infinity World Investments LLC.

SIGNATURE

After reasonable inquiry and to the best of my knowledge and belief, I certify that the information set forth in this statement is true, complete and correct.

Date: December 15, 2008

DUBAI WORLD,
a Dubai, United Arab Emirates government decree entity

/s/ George Dalton
Name: George Dalton, Esq.
Title: Group Chief Legal Officer

INFINITY WORLD HOLDING LTD.,
a Dubai, United Arab Emirates offshore corporation

/s/ Abdul Wahid A. Rahim Al Ulama
Name: Abdul Wahid A. Rahim Al Ulama
Title: Secretary

INFINITY WORLD CAYMAN INVESTMENTS CORPORATION,
a Cayman Islands exempted company

/s/ Abdul Wahid A. Rahim Al Ulama
Name: Abdul Wahid A. Rahim Al Ulama
Title: Secretary

INFINITY WORLD (CAYMAN) L.P.,
a Cayman Islands exempted limited partnership

By: Infinity World (Cayman) Holding
Its: General Partner

/s/ Abdul Wahid A. Rahim Al Ulama
Name: Abdul Wahid A. Rahim Al Ulama
Title: Secretary

INFINITY WORLD (CAYMAN) HOLDING,
a Cayman Islands exempted company

/s/ Abdul Wahid A. Rahim Al Ulama
Name: Abdul Wahid A. Rahim Al Ulama
Title: Secretary

INFINITY WORLD INVESTMENTS LLC,
a Nevada limited liability company

/s/ Abdul Wahid A. Rahim Al Ulama
Name: Abdul Wahid A. Rahim Al Ulama
Title: Secretary

INDEX TO EXHIBITS

No.	Description
1**	Confirmation dated as of December 13, 2007 by and between Credit Suisse International and Infinity World Investments LLC, filed as Exhibit 1 to the Schedule 13D jointly filed by Dubai World, Infinity World (Cayman) L.P., Infinity World (Cayman) Holding and Infinity World Holding Ltd. with the Securities and Exchange Commission on December 28, 2007 and incorporated herein by reference.
2**	Confirmation dated as of December 13, 2007 by and between Deutsche Bank AG, London Branch and Infinity World Investments LLC, filed as Exhibit 2 to the Schedule 13D jointly filed by Dubai World, Infinity World (Cayman) L.P., Infinity World (Cayman) Holding and Infinity World Holding Ltd. with the Securities and Exchange Commission on December 28, 2007 and incorporated herein by reference.
3**	Confirmation dated as of December 13, 2007 by and between The Royal Bank of Scotland plc and Infinity World Investments LLC, filed as Exhibit 3 to the Schedule 13D jointly filed by Dubai World, Infinity World (Cayman) L.P., Infinity World (Cayman) Holding and Infinity World Holding Ltd. with the Securities and Exchange Commission on December 28, 2007 and incorporated herein by reference.
4	Limited Liability Company Agreement dated as of August 21, 2007 by and between Mirage Resorts, Incorporated and Dubai World, filed as Exhibit (d)(3) to the Schedule TO-T jointly filed by Dubai World, Infinity World (Cayman) L.P. and Infinity World Investments LLC with the Securities and Exchange Commission on August 24, 2007 and incorporated herein by reference.
5	Amendment No. 1 to Limited Liability Company Agreement dated as of November 15, 2007 by and between Project CC, LLC and Infinity World Development Corp, filed as Exhibit (d)(3) to the Form 8-K filed by MGM MIRAGE with the Securities and Exchange Commission on November 21, 2007 and incorporated herein by reference.
6	Assignment and Assumption Agreement dated as of November 15, 2007, by and between Dubai World, as assignor, and Infinity World Development Corp, as assignee, filed as Exhibit 6 to the Schedule 13D jointly filed by Dubai World, Infinity World (Cayman) L.P., Infinity World (Cayman) Holding and Infinity World Holding Ltd. with the Securities and Exchange Commission on December 28, 2007 and incorporated herein by reference.
7	Company Stock Purchase and Support Agreement dated as of August, 21, 2007 by and between MGM MIRAGE and Infinity World Investments LLC, filed as Exhibit (d)(1) to the Schedule TO-T jointly filed by Dubai World, Infinity World (Cayman) L.P. and Infinity World Investments LLC with the Securities and Exchange Commission on August 24, 2007 and incorporated herein by reference.
8	Stock Purchase Agreement dated as of December 18, 2007, by and between The Lincy Foundation and Infinity World (Cayman) L.P., filed as Exhibit 8 to the Schedule 13D jointly filed by Dubai World, Infinity World (Cayman) L.P., Infinity World (Cayman) Holding and Infinity World Holding Ltd. with the Securities and Exchange Commission on December 28, 2007 and incorporated herein by reference.
9	Stockholder Support Agreement dated as of August 21, 2007, by and between Tracinda Corporation and Infinity World Investments LLC, filed as Exhibit (d)(2) to the Schedule TO-T jointly filed by Dubai World, Infinity World (Cayman) L.P. and Infinity World Investments LLC with the Securities and Exchange Commission on August 24, 2007 and incorporated herein by reference.
10**	Pledge Agreement dated as of December 13, 2007 by and among Infinity World Investments LLC, Credit Suisse International, Deutsche Bank AG, London Branch and The Royal Bank of Scotland plc, as Initial Banks, and Deutsche Bank Trust Company Americas, as Collateral Agent, filed as Exhibit 10 to the Schedule 13D jointly filed by Dubai World, Infinity World (Cayman) L.P., Infinity World (Cayman) Holding and Infinity World Holding Ltd. with the Securities and Exchange Commission on December 28, 2007 and incorporated herein by reference.
11**	Liquidity Agreement dated as of December 13, 2007 by and among Dubai World, Infinity World Investments LLC, Credit Suisse International, Deutsche Bank AG, London Branch and The Royal Bank of Scotland plc, as Initial Banks, and Deutsche Bank Trust Company Americas, as Collateral Agent, filed as Exhibit 11 to the Schedule 13D jointly filed by Dubai World, Infinity World (Cayman) L.P., Infinity World (Cayman) Holding and Infinity World Holding Ltd. with the Securities and Exchange Commission on December 28, 2007 and incorporated herein by reference.

12**	Letter Agreement dated as of December 13, 2007 by and among Dubai World, Credit Suisse International, Deutsche Bank AG, London Branch, Deutsche Bank Securities Inc., as agent, and The Royal Bank of Scotland plc, filed as Exhibit 12 to the Schedule 13D jointly filed by Dubai World, Infinity World (Cayman) L.P., Infinity World (Cayman) Holding and Infinity World Holding Ltd. with the Securities and Exchange Commission on December 28, 2007 and incorporated herein by reference.
13	Joint Filing Agreement dated as of December 28, 2007 by and among Dubai World, Infinity World (Cayman) L.P., Infinity World (Cayman) Holding and Infinity World Holding Ltd., filed as Exhibit 13 to the Schedule 13D jointly filed by Dubai World, Infinity World (Cayman) L.P., Infinity World (Cayman) Holding and Infinity World Holding Ltd. with the Securities and Exchange Commission on December 28, 2007 and incorporated herein by reference.
14	Press Release, dated January 9, 2008, filed with the Schedule TO-C jointly filed by MGM MIRAGE, Dubai World and Infinity World (Cayman) L.P. with the Securities and Exchange Commission on January 16, 2008 and incorporated herein by reference.
15	Press Release, dated January 16, 2008, filed with the Schedule TO-C jointly filed by MGM MIRAGE, Dubai World and Infinity World (Cayman) L.P. with the Securities and Exchange Commission on January 16, 2008 and incorporated herein by reference.
16	Amendment No. 2 to Limited Liability Company Agreement dated as of December 31, 2007 by and between Project CC, LLC and Infinity World Development Corp, filed as Exhibit 10.1 to the Form 8-K filed by MGM MIRAGE with the Securities and Exchange Commission on December 31, 2007 and incorporated herein by reference.
17	Amended and Restated Joint Filing Agreement dated as of February 26, 2008 by and among Dubai World, Infinity World (Cayman) L.P., Infinity World (Cayman) Holding, Infinity World Holding Ltd, Infinity World Investments LLC and Infinity World Cayman Investments Corporation, filed as Exhibit 17 to the Schedule 13D jointly filed by Dubai World, Infinity World (Cayman) L.P., Infinity World (Cayman) Holding, Infinity World Holding Ltd., Infinity World Cayman Investments Corporation and Infinity World Investments LLC with the Securities and Exchange Commission on February 27, 2008 and incorporated herein by reference.
18	Offer to Purchase, dated August 27, 2007, filed as Exhibit (a)(1)(A) to the Schedule TO-T jointly filed by Dubai World, Infinity World (Cayman) L.P. and Infinity World Investments LLC with the Securities and Exchange Commission on August 24, 2007 and incorporated herein by reference.
19	Letter of Transmittal, filed as Exhibit (a)(1)(B) to the Schedule TO-T jointly filed by Dubai World, Infinity World (Cayman) L.P. and Infinity World Investments LLC with the Securities and Exchange Commission on August 24, 2007 and incorporated herein by reference.
20	Notice of Guaranteed Delivery, filed as Exhibit (a)(1)(C) to the Schedule TO-T jointly filed by Dubai World, Infinity World (Cayman) L.P. and Infinity World Investments LLC with the Securities and Exchange Commission on August 24, 2007 and incorporated herein by reference.
21	Letter to Brokers, Dealers, Commercial Banks, Trust Companies and Other Nominees, filed as Exhibit (a)(1)(D) to the Schedule TO-T jointly filed by Dubai World, Infinity World (Cayman) L.P. and Infinity World Investments LLC with the Securities and Exchange Commission on August 24, 2007 and incorporated herein by reference.
22	Letter to Clients for Use by Brokers, Dealers, Commercial Banks, Trust Companies and Other Nominees, filed as Exhibit (a)(1)(E) to the Schedule TO-T jointly filed by Dubai World, Infinity World (Cayman) L.P. and Infinity World Investments LLC with the Securities and Exchange Commission on August 24, 2007 and incorporated herein by reference.
23	Guidelines for Certification of Taxpayer Identification Number on Substitute Form W-9, filed as Exhibit (a)(1)(F) to the Schedule TO-T jointly filed by Dubai World, Infinity World (Cayman) L.P. and Infinity World Investments LLC with the Securities and Exchange Commission on August 24, 2007 and incorporated herein by reference.
24	Summary Advertisement, filed as Exhibit (a)(1)(H) to the Schedule TO-T jointly filed by Dubai World, Infinity World (Cayman) L.P. and Infinity World Investments LLC with the Securities and Exchange Commission on August 24, 2007 and incorporated herein by reference.
25	Supplement to Offer to Purchase, filed as Exhibit (a)(1)(I) to Amendment No. 1 to the Schedule TO-T jointly filed by Dubai World, Infinity World (Cayman) L.P. and Infinity World Investments LLC with the Securities and Exchange Commission on August 27, 2007 and incorporated herein by reference.

26	Summary Advertisement, filed as Exhibit (a)(1)(K) to Amendment No. 1 to the Schedule TO-T jointly filed by Dubai World, Infinity World (Cayman) L.P. and Infinity World Investments LLC with the Securities and Exchange Commission on August 27, 2007 and incorporated herein by reference.
27	Supplement No. 2 to Offer to Purchase, filed as Exhibit (a)(1)(M) to Amendment No. 3 to the Schedule TO-T jointly filed by Dubai World, Infinity World (Cayman) L.P. and Infinity World Investments LLC with the Securities and Exchange Commission on October 1, 2007 and incorporated herein by reference.
28	Offer to Purchase, dated January 17, 2008, filed as Exhibit (a)(1)(A) to the Schedule TO-I jointly filed by MGM MIRAGE, Dubai World and Infinity World (Cayman) L.P. with the Securities and Exchange Commission on January 17, 2008 and incorporated herein by reference.
29	Letter of Transmittal to Tender Shares of Common Stock, filed as Exhibit (a)(1)(B) to the Schedule TO-I jointly filed by MGM MIRAGE, Dubai World and Infinity World (Cayman) L.P. with the Securities and Exchange Commission on January 17, 2008 and incorporated herein by reference.
30	Notice of Guaranteed Delivery, filed as Exhibit (a)(1)(C) to the Schedule TO-I jointly filed by MGM MIRAGE, Dubai World and Infinity World (Cayman) L.P. with the Securities and Exchange Commission on January 17, 2008 and incorporated herein by reference.
31	Letter to Brokers, Dealers, Commercial Banks, Trust Companies and Other Nominees, filed as Exhibit (a)(1)(D) to the Schedule TO-I jointly filed by MGM MIRAGE, Dubai World and Infinity World (Cayman) L.P. with the Securities and Exchange Commission on January 17, 2008 and incorporated herein by reference.
32	Letter to Clients for Use by Brokers, Dealers, Commercial Banks, Trust Companies and Other Nominees, filed as Exhibit (a)(1)(E) to the Schedule TO-I jointly filed by MGM MIRAGE, Dubai World and Infinity World (Cayman) L.P. with the Securities and Exchange Commission on January 17, 2008 and incorporated herein by reference.
33	Guidelines for Certification of Taxpayer Identification Number on Substitute Form W-9, filed as Exhibit (a)(1)(F) to the Schedule TO-I jointly filed by MGM MIRAGE, Dubai World and Infinity World (Cayman) L.P. with the Securities and Exchange Commission on January 17, 2008 and incorporated herein by reference.
34	Summary Advertisement, filed as Exhibit (a)(1)(I) to the Schedule TO-I jointly filed by MGM MIRAGE, Dubai World and Infinity World (Cayman) L.P. with the Securities and Exchange Commission on January 17, 2008 and incorporated herein by reference.
35	Joint Tender Offer Agreement, dated January 17, 2008, between MGM MIRAGE and Infinity World (Cayman) L.P., filed as Exhibit (d)(7) to the Schedule TO-I jointly filed by MGM MIRAGE, Dubai World and Infinity World (Cayman) L.P. with the Securities and Exchange Commission on January 17, 2008 and incorporated herein by reference.
36 **	Amended and Restated Confirmation dated as of April 21, 2008 by and among Credit Suisse International, Infinity World (Cayman) L.P. and Infinity World Investments LLC, filed as Exhibit 36 to the Schedule 13D jointly filed by Dubai World, Infinity World (Cayman) L.P., Infinity World (Cayman) Holding, Infinity World Holding Ltd., Infinity World Cayman Investments Corporation and Infinity World Investments LLC with the Securities and Exchange Commission on April 29, 2008 and incorporated herein by reference.
37 **	Amended and Restated Confirmation dated as of April 21, 2008 by and among Deutsche Bank AG, London Branch, Infinity World (Cayman) L.P. and Infinity World Investments LLC, filed as Exhibit 37 to the Schedule 13D jointly filed by Dubai World, Infinity World (Cayman) L.P., Infinity World (Cayman) Holding, Infinity World Holding Ltd., Infinity World Cayman Investments Corporation and Infinity World Investments LLC with the Securities and Exchange Commission on April 29, 2008 and incorporated herein by reference.
38 **	Amended and Restated Confirmation dated as of April 21, 2008 by and among The Royal Bank of Scotland plc, Infinity World (Cayman) L.P. and Infinity World Investments LLC, filed as Exhibit 38 to the Schedule 13D jointly filed by Dubai World, Infinity World (Cayman) L.P., Infinity World (Cayman) Holding, Infinity World Holding Ltd., Infinity World Cayman Investments Corporation and Infinity World Investments LLC with the Securities and Exchange Commission on April 29, 2008 and incorporated herein by reference.

39 ** Amended and Restated Pledge Agreement dated as of April 21, 2008 by and among Infinity World Investments LLC, Infinity World (Cayman) L.P., Credit Suisse International, Deutsche Bank AG, London Branch and The Royal Bank of Scotland plc, as Initial Banks, and Deutsche Bank Trust Company Americas, as Collateral Agent, filed as Exhibit 39 to the Schedule 13D jointly filed by Dubai World, Infinity World (Cayman) L.P., Infinity World (Cayman) Holding, Infinity World Holding Ltd., Infinity World Cayman Investments Corporation and Infinity World Investments LLC with the Securities and Exchange Commission on April 29, 2008 and incorporated herein by reference.

40 ** Amended and Restated Liquidity Agreement dated as of April 21, 2008 by and among Dubai World, Infinity World Investments LLC, Infinity World (Cayman) L.P., Credit Suisse International, Deutsche Bank AG, London Branch and The Royal Bank of Scotland plc, as Initial Banks, and Deutsche Bank Trust Company Americas, as Collateral Agent, filed as Exhibit 40 to the Schedule 13D jointly filed by Dubai World, Infinity World (Cayman) L.P., Infinity World (Cayman) Holding, Infinity World Holding Ltd., Infinity World Cayman Investments Corporation and Infinity World Investments LLC with the Securities and Exchange Commission on April 29, 2008 and incorporated herein by reference.

41 ** Amendment to the Letter Agreement dated as of April 21, 2008 by and among Dubai World, Credit Suisse International, Deutsche Bank AG, London Branch, Deutsche Bank Securities Inc., as agent, and The Royal Bank of Scotland plc, filed as Exhibit 41 to the Schedule 13D jointly filed by Dubai World, Infinity World (Cayman) L.P., Infinity World (Cayman) Holding, Infinity World Holding Ltd., Infinity World Cayman Investments Corporation and Infinity World Investments LLC with the Securities and Exchange Commission on April 29, 2008 and incorporated herein by reference.

42 ** Second Amendment to Confirmation dated as of June 23, 2008 by and among Credit Suisse International, Infinity World (Cayman) L.P. and Infinity World Investments LLC., filed as Exhibit 42 to the Schedule 13D jointly filed by Dubai World, Infinity World (Cayman) L.P., Infinity World (Cayman) Holding, Infinity World Holding Ltd., Infinity World Cayman Investments Corporation and Infinity World Investments LLC with the Securities and Exchange Commission on June 25, 2008 and incorporated herein by reference.

43 ** Second Amendment to Confirmation dated as of June 23, 2008 by and among Deutsche Bank AG, London Branch, Infinity World (Cayman) L.P. and Infinity World Investments LLC, filed as Exhibit 43 to the Schedule 13D jointly filed by Dubai World, Infinity World (Cayman) L.P., Infinity World (Cayman) Holding, Infinity World Holding Ltd., Infinity World Cayman Investments Corporation and Infinity World Investments LLC with the Securities and Exchange Commission on June 25, 2008 and incorporated herein by reference.

44 ** Second Amendment to Confirmation dated as of June 23, 2008 by and among The Royal Bank of Scotland plc, Infinity World (Cayman) L.P. and Infinity World Investments LLC, filed as Exhibit 44 to the Schedule 13D jointly filed by Dubai World, Infinity World (Cayman) L.P., Infinity World (Cayman) Holding, Infinity World Holding Ltd., Infinity World Cayman Investments Corporation and Infinity World Investments LLC with the Securities and Exchange Commission on June 25, 2008 and incorporated herein by reference.

45 ** Second Amended and Restated Liquidity Agreement dated as of August 7, 2008 by and among Dubai World, Infinity World Investments LLC, Infinity World (Cayman) L.P., Credit Suisse International, Deutsche Bank AG, London Branch and The Royal Bank of Scotland plc, as Initial Banks, and Deutsche Bank Trust Company Americas, as Collateral Agent, filed as Exhibit 45 to the Schedule 13D jointly filed by Dubai World, Infinity World (Cayman) L.P., Infinity World (Cayman) Holding, Infinity World Holding Ltd., Infinity World Cayman Investments Corporation and Infinity World Investments LLC with the Securities and Exchange Commission on August 15, 2008 and incorporated herein by reference.

46 Third Amendment to Confirmation dated as of November 4, 2008 by and among Credit Suisse International, Infinity World (Cayman) L.P. and Infinity World Investments LLC, filed as Exhibit 46 to the Schedule 13D jointly filed by Dubai World, Infinity World (Cayman) L.P., Infinity World (Cayman) Holding, Infinity World Holding Ltd., Infinity World Cayman Investments Corporation and Infinity World Investments LLC with the Securities and Exchange Commission on November 7, 2008 and incorporated herein by reference.

47	Third Amendment to Confirmation dated as of November 4, 2008 by and among Deutsche Bank AG, London Branch, Infinity World (Cayman) L.P. and Infinity World Investments LLC, filed as Exhibit 47 to the Schedule 13D jointly filed by Dubai World, Infinity World (Cayman) L.P., Infinity World (Cayman) Holding, Infinity World Holding Ltd., Infinity World Cayman Investments Corporation and Infinity World Investments LLC with the Securities and Exchange Commission on November 7, 2008 and incorporated herein by reference.
48	Third Amendment to Confirmation dated as of November 4, 2008 by and among The Royal Bank of Scotland plc, Infinity World (Cayman) L.P. and Infinity World Investments LLC, filed as Exhibit 48 to the Schedule 13D jointly filed by Dubai World, Infinity World (Cayman) L.P., Infinity World (Cayman) Holding, Infinity World Holding Ltd., Infinity World Cayman Investments Corporation and Infinity World Investments LLC with the Securities and Exchange Commission on November 7, 2008 and incorporated herein by reference.
49	Guarantee dated as of November 4, 2008 by and among Dubai World, Credit Suisse International, Deutsche Bank AG, London Branch, and The Royal Bank of Scotland plc, filed as Exhibit 49 to the Schedule 13D jointly filed by Dubai World, Infinity World (Cayman) L.P., Infinity World (Cayman) Holding, Infinity World Holding Ltd., Infinity World Cayman Investments Corporation and Infinity World Investments LLC with the Securities and Exchange Commission on November 7, 2008 and incorporated herein by reference.
50	Amendment No. 1 to Amended and Restated Pledge Agreement dated as of November 4, 2008 by and among Infinity World Investments LLC, Infinity World (Cayman) L.P., Credit Suisse International, Deutsche Bank AG, London Branch, The Royal Bank of Scotland plc and Deutsche Bank Trust Company Americas, as collateral agent, filed as Exhibit 50 to the Schedule 13D jointly filed by Dubai World, Infinity World (Cayman) L.P., Infinity World (Cayman) Holding, Infinity World Holding Ltd., Infinity World Cayman Investments Corporation and Infinity World Investments LLC with the Securities and Exchange Commission on November 7, 2008 and incorporated herein by reference.
51*	Payoff Letter dated as of December 10, 2008 by and among Credit Suisse International, Deutsche Bank AG, London Branch, The Royal Bank of Scotland plc, Deutsche Bank Trust Company Americas, as Collateral Agent, Infinity World (Cayman) L.P. and Infinity World Investments LLC.

* Filed herewith.

** Portions have been omitted pursuant to a request for confidential treatment.

Previously filed.

9,244

5,223

3,323

2,581

2,796

Net interest income before provision for loan losses

92,394

75,701

65,182

60,126

52,325

(Benefit) provision for loan losses

4,350

(1,140

)

—

—

350

Non-interest income

21,564

21,779

19,238

17,715

15,831

Non-interest expense

70,024

65,441

58,053

50,703

—

Income before provision for income taxes

39,584

33,179

26,367

27,138

21,431

Provision for income taxes

9,907

13,640

8,800

9,071

6,191

Net income

29,677

19,539

17,567

18,067

15,240

Selected Balance Sheet Summary

Total loans, net

1,724,780

1,551,551

1,255,754

1,124,602

961,056

Allowance for loan losses

9,750

9,043

9,701

10,423

11,248

Securities available for sale

560,479

558,329

530,083

507,582

511,883

Cash and due from banks

74,132

70,137

120,442

48,623

50,095

Foreclosed assets

1,082

5,481

2,225

3,193

3,991

Premises and equipment, net

29,500

29,388

28,893

21,990

21,853

Total interest-earning assets

2,286,952

2,118,875

1,827,192

1,634,180

1,474,629

Total assets

2,522,502

2,340,298

2,032,873

1,796,537

1,637,320

Total interest-bearing liabilities

1,561,039

1,417,590

1,277,416

1,150,010

1,038,177

Total deposits

2,116,340

1,988,386

1,695,471

1,464,628

1,366,695

Total liabilities

2,249,478

2,084,356

1,826,995

1,606,197

1,450,229

Total shareholders' equity

273,024

255,942

205,878

190,340

187,091

Per Share Data

Net income per basic share

1.94

1.38

1.30

1.34

1.09

Net income per diluted share

1.92

1.36

1.29

1.33

1.08

Book value

17.84

16.81

14.94

14.36

13.67

Cash dividends

0.64

0.56

0.48

0.42

0.34

Weighted average common shares outstanding basic

15,261,794

14,172,196

13,530,293

13,460,605

14,001,958

Weighted average common shares outstanding diluted

15,432,120

14,357,782

13,651,804

13,585,110

14,136,486

Key Operating Ratios:

Performance Ratios: [1]

Return on average equity

11.37

%

8.82

%

8.71

%

9.59

%

8.18

%

Return on average assets

1.23

%

0.93

%

0.95

%

1.07

%

1.03

%

Net interest spread (tax-equivalent) (4)

4.03

%

3.90

%

3.86

%

3.92

%

3.92

%

Net interest margin (tax-equivalent)

4.24

%

4.04

%

3.95

%

3.99

%

4.01

%

Dividend payout ratio

32.99

%

40.61

%

36.97

%

31.29

%

31.33

%

Equity to assets ratio

10.80

%

10.53

%

10.93

%

11.13

%

12.58

%

Efficiency ratio (tax-equivalent)

60.79

%

65.52

%

67.23

%

63.98

%

66.30

%

Net loans to total Deposits at Period end

81.50

%

78.03

%

74.07

%

70.32

%

70.32

%

Asset Quality Ratios: [1]

Non-performing loans to total loans [(2)]

0.30

%

0.25

%

0.50

%

0.85

%

2.13

%

Non-performing assets to total loans and other real estate owned [(2)]

0.36

%

0.60

%

0.68

%

1.13

%

2.53

%

Net (recoveries) charge-offs to average loans

0.22

%

-0.04

%

0.06

%

0.08

%

0.09

%

Allowance for loan losses to net loans at period end

-0.57

%

-0.58

%

-0.77

%

-0.93

%

-1.17

%

Allowance for Loan Losses to Non-Performing Loans

-189.10

%

-228.19

%

-152.41

%

-108.19

%

-54.40

%

Regulatory Capital Ratios: [3]

Common equity tier 1 capital to risk-weighted assets

12.61

%

12.84

%

14.09

%

N/A

N/A

Tier 1 capital to adjusted average assets (leverage ratio)

11.49

%

11.32

%

11.92

%

12.99

%

12.99

%

Tier 1 capital to risk-weighted assets

14.38

%

14.79

%

16.53

%

17.39

%

17.39

%

Total capital to risk-weighted assets

14.89

%

15.32

%

17.25

%

18.44

%

18.44

%

(1) Asset quality ratios are end of period ratios. Performance ratios are based on average daily balances during the periods indicated.
(2) Performing TDR’s are not included in nonperforming loans and are therefore not included in the numerators used to calculate these ratios.
(3) For definitions and further information relating to regulatory capital requirements, see “Item 1, Business - Supervision and Regulation - Capital Adequacy Requirements herein.
(4) Represents the average rate earned on interest-earning assets less the average rate paid on interest-bearing liabilities.

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Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

This discussion presents Management's analysis of the Company's financial condition as of December 31, 2018 and 2017, and the results of operations for each year in the three-year period ended December 31, 2018. The discussion should be read in conjunction with the Company's consolidated financial statements and the notes related thereto presented elsewhere in this Form 10-K Annual Report (see Item 8 below).

Statements contained in this report or incorporated by reference that are not purely historical are forward looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934 as amended, including the Company's expectations, intentions, beliefs, or strategies regarding the future. All forward-looking statements concerning economic conditions, growth rates, income, expenses, or other values which are included in this document are based on information available to the Company on the date noted, and the Company assumes no obligation to update any such forward-looking statements. It is important to note that the Company's actual results could materially differ from those in such forward-looking statements. Risk factors that could cause actual results to differ materially from those in forward-looking statements include but are not limited to those outlined previously in Item 1A.

Critical Accounting Policies

The Company's financial statements are prepared in accordance with accounting principles generally accepted in the United States. The financial information and disclosures contained within those statements are significantly impacted by Management's estimates and judgments, which are based on historical experience and incorporate various assumptions that are believed to be reasonable under current circumstances. Actual results may differ from those estimates under divergent conditions.

Critical accounting policies are those that involve the most complex and subjective decisions and assessments, and have the greatest potential impact on the Company's stated results of operations. In Management's opinion, the Company's critical accounting policies deal with the following areas: the establishment of an allowance for loan and lease losses, as explained in detail in Note 2 to the consolidated financial statements and in the "Provision for Loan Losses" and "Allowance for Loan and Lease Losses" sections of this discussion and analysis; the valuation of impaired loans and foreclosed assets, as discussed in Note 2 to the consolidated financial statements; income taxes and deferred tax assets and liabilities, especially with regard to the ability of the Company to recover deferred tax assets as discussed in the "Provision for Income Taxes" and "Other Assets" sections of this discussion and analysis; and goodwill and other intangible assets, which are evaluated annually for impairment and for which we have determined that no impairment exists, as discussed in Note 2 to the consolidated financial statements and in the "Other Assets" section of this discussion and analysis. Critical accounting areas are evaluated on an ongoing basis to ensure that the Company's financial statements incorporate the most recent expectations with regard to those areas.

Overview of the Results of Operations and Financial Condition

Results of Operations Summary

The Company recognized net income of $29.677 million in 2018, relative to $19.539 million in 2017 and $17.567 million in 2016. Net income per diluted share was $1.92 in 2018, as compared to $1.36 in 2017 and $1.29 for 2016. The Company's return on average assets and return on average equity were 1.23% and 11.37%, respectively, in 2018, as compared to 0.93% and 8.82%, respectively, in 2017 and 0.95% and 8.71%, respectively, for 2016. Our operating results and balance sheet have been materially impacted in recent periods by whole-bank acquisitions and nonrecurring items, as discussed in greater detail in the applicable sections below. Furthermore, the Company's financial performance was favorably affected by a substantially lower corporate income tax rate starting in 2018, but was negatively impacted in 2017 by a $2.710 million charge to our income tax provision as we revalued our net deferred tax asset to reflect the lower income tax rate enacted at the end of the year. Excluding the impact of nonrecurring items, our core financial results have been trending better for the past several years due in part to a higher volume of loans, a strong base of core deposits, and reductions in nonperforming assets. The following is a summary of the major factors that impacted the Company's results of operations for the years presented in the consolidated financial statements.

- Net interest income improved by 22% in 2018 over 2017 and 16% in 2017 over 2016, due primarily to growth in average interest-earning assets. The increase in average earning assets in 2018 over 2017 was largely organic, resulting from concerted business development efforts and lending opportunities inherent in expanded markets. The increase in 2017 over 2016 was the result of our acquisitions of Coast National Bank in mid-2016 and Ojai Community Bank in the fourth quarter of 2017, organic loan growth, and a higher level of investments. The positive impact of asset growth was enhanced by net interest margin expansion of 20 basis points in 2018 and nine basis points in 2017, resulting in part from short-term interest rate increases, discount accretion on acquisition loans, and a favorable shift in our mix of interest-earning assets. Net interest income has also been impacted by nonrecurring interest items, which added $277,000 to interest income in 2018 relative to $736,000 in 2017 and $563,000 in 2016.
- We recorded a loan loss provision of $4.350 million in 2018, relative to a negative provision of $1.140 million in 2017 and no provision for 2016. The 2018 provision was deemed necessary subsequent to our determination of the appropriate level for our allowance for loan and lease losses, taking into consideration overall credit quality, growth in outstanding loan balances, and reserves required for specifically identified impaired loan balances (including $2.4 million for a large purchased participation loan that was placed on non-accrual status in the third quarter). The provision reversal in 2017 was made possible by principal recovered on charged-off loan balances, and the zero provision for 2016 was facilitated by the reduction of impaired loan balances, lower loan losses, and tighter underwriting standards for new and renewed loans.
- Noninterest income fell by $215,000, or 1%, in 2018 over 2017, but improved by $2.541 million, or 13%, in 2017 compared to 2016. The decline in 2018 occurred as gains in deposit service charges, debit card interchange income, and other fees were offset by lower income from bank-owned life insurance ("BOLI") associated with deferred compensation plans, and a drop in nonrecurring income including the impact of an expense amortization adjustment on our tax credit investments (reflected as an offset to income). The improvement in 2017 is comprised primarily of growth in service charges on deposit accounts and other core fee income, but also includes nonrecurring items as discussed below.
- Operating expense increased by $4.583 million, or 7%, in 2018 over 2017, and by $7.388 million, or 13%, in 2017 compared to 2016. The escalation for 2018 includes the impact of acquisitions on ongoing operating costs and a relatively large increase in group health insurance costs, partially offset by favorable swings of $1.776 million in nonrecurring acquisition costs, $1.000 million in net foreclosed asset costs, and $698,000 in directors deferred compensation expense (related to the drop in BOLI income). Most of the 2017 increase came from higher operating costs associated with branches added via our acquisitions as well as de novo branch expansion. Nonrecurring costs, including those related to acquisitions, are delineated below.
- The Company recorded income tax provisions of $9.907 million, or 25% of pre-tax income in 2018; $13.640 million, or 41% of pre-tax income in 2017; and $8.800 million, or 33% of pre-tax income in 2016. The lower tax rate for 2018 resulted from a reduction in our federal income tax rate starting in 2018. The relatively high tax accrual rate for 2017 over 2016 is primarily the result of the aforementioned $2.710 million deferred tax asset revaluation charge, but also reflects higher taxable income relative to available tax credits.

Financial Condition Summary

The Company's assets totaled $2.523 billion at December 31, 2018, relative to $2.340 billion at December 31, 2017. Total liabilities were $2.249 billion at the end of 2018 compared to $2.084 billion at the end of 2017, and shareholders' equity totaled $273 million at December 31, 2018 relative to $256 million at December 31, 2017. The following is a summary of key balance sheet changes during 2018.

- Total assets increased by $182 million, or 8%. The increase resulted primarily from net loan growth.
- Gross loans and leases were up $174 million, or 11%. Loan growth consisted mainly of strong organic growth in real estate loans, largely occurring in commercial real estate and construction loans. Mortgage warehouse loans were down $46 million, or 33%, primarily because a lower utilization rate on mortgage warehouse lines, and commercial and consumer loan balances also declined.
- Deposit balances reflect net growth of $128 million, or 6%. Deposit growth in 2018 includes deposits in our acquired Lompoc branch totaling about $34 million at the reporting date, and the addition of $50 million in wholesale brokered deposits. Core non-maturity deposits fell by close to $8 million, as the Bank's time deposit

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promotion in the fourth quarter resulted in some internal cannibalization of money market deposits in particular, which were down by $48 million, or 28%. Customer time deposits increased by $86 million, or 23%, during 2018, due in large part to the promotion.

- Total capital increased by $17 million, or 7%, ending the year with a balance of $273 million. The increase in capital is due to the addition of net income and capital from stock options exercised, net of dividends paid, and a $4.3 million increase in our accumulated other comprehensive loss.

Results of Operations

As noted above, acquisitions have had a material impact on our operating results in recent periods, including the recognition of nonrecurring acquisition costs as well as higher revenues and ongoing overhead expense. Our results were also materially affected by the reduction in our federal income tax rate, which was enacted at the end of 2017 and became effective at the beginning of 2018. Net income was $29.677 million in 2018, an increase of $10.138 million, or 52%, relative to 2017. Net income also increased by $1.972 million, or 11%, in 2017 compared to 2016. The Company earns income from two primary sources. The first is net interest income, which is interest income generated by earning assets less interest expense on deposits and other borrowed money. The second is noninterest income, which primarily consists of customer service charges and fees but also comes from non-customer sources such as bank-owned life insurance and investment gains. The majority of the Company’s noninterest expense is comprised of operating costs that facilitate offering a full range of banking services to our customers.

Net Interest Income and Net Interest Margin

Net interest income was $92.394 million in 2018, compared to $75.701 million in 2017 and $65.182 million in 2016. This equates to increases of 22% in 2018 and 16% in 2017. The level of net interest income we recognize in any given period depends on a combination of factors including the average volume and yield for interest-earning assets, the average volume and cost of interest-bearing liabilities, and the mix of products which comprise the Company’s earning assets, deposits, and other interest-bearing liabilities. Net interest income is also impacted by the reversal of interest for loans placed on non-accrual status, and the recovery of interest on loans that had been on non-accrual and were paid off, sold or returned to accrual status.

The following table shows average balances for significant balance sheet categories and the amount of interest income or interest expense associated with each category for each of the past three years. The table also displays calculated yields on each major component of the Company’s investment and loan portfolios, average rates paid on each key segment of the Company’s interest-bearing liabilities, and our net interest margin for the noted periods.

Distribution, Rate & Yield
(dollars in thousands, except footnotes)

	Year Ended December 31,								
	2018			2017			2016		
Assets	Average Balance(1)	Income/ Expense	Average Rate/Yield(2)	Average Balance(1)	Income/ Expense	Average Rate/Yield(2)	Average Balance(1)	Income/ Expense	Average Rate/Yield(2)
Investments:									
Federal funds sold/due from banks	$13,237	$238	1.77 %	$34,832	$356	1.01 %	$11,210	$84	0.74 %
Taxable	422,848	9,548	2.23 %	437,194	8,614	1.94 %	415,902	7,922	1.87 %
Non-taxable	140,300	4,060	3.66 %	133,506	3,711	4.28 %	108,568	3,009	4.26 %
Equity	—	—	—	1,128	16	1.40 %	1,214	40	3.24 %
Total investments	576,385	13,846	2.55 %	606,660	12,697	2.39 %	536,894	11,055	2.32 %
Loans and Leases: (3)									
Real estate	1,350,425	73,006	5.41 %	1,029,224	53,329	5.18 %	827,868	42,107	5.09 %
Agricultural	52,031	2,980	5.73 %	49,335	2,448	4.96 %	48,730	2,143	4.40 %
Commercial	124,809	5,969	4.78 %	120,307	6,252	5.20 %	116,135	5,915	5.09 %
Consumer	9,755	1,251	12.82 %	11,471	1,329	11.59 %	13,789	1,574	11.41 %
Mortgage warehouse	86,030	4,415	5.13 %	105,352	4,690	4.45 %	144,531	5,577	3.86 %
Other	2,682	171	6.38 %	3,220	179	5.56 %	2,187	134	6.13 %
Total loans and leases	1,625,732	87,792	5.40 %	1,318,909	68,227	5.17 %	1,153,240	57,450	4.98 %
Total interest earning assets (4)	2,202,117	101,638	4.66 %	1,925,569	80,924	4.31 %	1,690,134	68,505	4.15 %
Other earning assets	10,514			9,018			8,045		
Non-earning assets	204,316			170,229			146,361		
Total assets	$2,416,947			$2,104,816			$1,844,540		
Liabilities and shareholders' equity									
Interest bearing deposits:									
Demand deposits	$119,432	$364	0.30 %	$135,713	$417	0.31 %	$131,803	$399	0.30 %
NOW	425,596	478	0.11 %	380,626	427	0.11 %	327,961	361	0.11 %
Savings accounts	298,021	314	0.11 %	241,746	258	0.11 %	206,234	229	0.11 %
Money market	149,024	146	0.10 %	136,915	157	0.11 %	109,027	80	0.07 %
CDAR's	—	—	—	32	—	—	3,700	4	0.11 %
Certificates of deposit<$100,000	81,940	614	0.75 %	74,847	292	0.39 %	75,383	236	0.31 %
Certificates of deposit>$100,000	310,880	5,039	1.62 %	274,298	2,211	0.81 %	238,858	865	0.36 %
Brokered deposits	16,822	305	1.81 %	—	—	—	—	—	—
Total interest bearing deposits	1,401,715	7,260	0.52 %	1,244,177	3,762	0.30 %	1,092,966	2,174	0.20 %
Borrowed funds:									
	22	—	—	166	1	0.60 %	822	6	0.73 %

Federal funds purchased									
Repurchase agreements	14,332	57	0.40 %	8,514	34	0.40 %	8,371	33	0.39 %
Short term borrowings	8,967	196	2.19 %	7,074	58	0.82 %	28,333	127	0.45 %
Long term borrowings	—	—	—	—	—	—	306	—	—
TRUPS	34,673	1,731	4.99 %	34,496	1,368	3.97 %	33,403	983	2.94 %
Total borrowed funds	57,994	1,984	3.42 %	50,250	1,461	2.91 %	71,235	1,149	1.61 %
Total interest bearing liabilities	1,459,709	9,244	0.63 %	1,294,427	5,223	0.40 %	1,164,201	3,323	0.29 %
Non-interest bearing demand deposits	665,941			557,686			462,200		
Other liabilities	30,383			31,062			16,521		
Shareholders' equity	260,914			221,641			201,618		
Total liabilities and shareholders' equity	$2,416,947			$2,104,816			$1,844,540		
Interest income/interest earning assets			4.66 %			4.31 %			4.15 %
Interest expense/interest earning assets			0.42 %			0.27 %			0.20 %
Net interest income and margin(5)		$92,394	4.24 %		$75,701	4.04 %		$65,182	3.95 %

(1) Average balances are obtained from the best available daily or monthly data and are net of deferred fees and related direct costs.

(2) Yields and net interest margin have been computed on a tax equivalent basis.

(3) Loans are gross of the allowance for possible loan losses. Net loan fees have been included in the calculation of interest income. Net loan fees and loan acquisition FMV amortization were $818,440, $629,660, and $461,003 for the years ended December 31, 2018, 2017, and 2016 respectively.

(4) Non-accrual loans are slotted by loan type and have been included in total loans for purposes of total interest earning assets.

(5) Net interest margin represents net interest income as a percentage of average interest-earning assets (tax-equivalent).

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The Volume and Rate Variances table below sets forth the dollar difference for the comparative periods in interest earned or paid for each major category of interest-earning assets and interest-bearing liabilities, and the amount of such change attributable to fluctuations in average balances (volume) or differences in average interest rates. Volume variances are equal to the increase or decrease in average balances multiplied by prior period rates, and rate variances are equal to the change in rates multiplied by prior period average balances. Variances attributable to both rate and volume changes, calculated by multiplying the change in rates by the change in average balances, have been allocated to the rate variance.

Volume & Rate Variances
(dollars in thousands)

	Years Ended December 31, 2018 over 2017 Increase(decrease) due to			2017 over 2016 Increase(decrease) due to		
Assets:	Volume	Rate	Net	Volume	Rate	Net
Investments:						
Federal funds sold/due from time	$(221)	$103	$(118)	$176	$96	$272
Taxable	(317)	1,251	934	419	273	692
Non-taxable	189	160	349	691	11	702
Equity	(16)	—	(16)	(3)	(21)	(24)
Total investments	(365)	1,514	1,149	1,283	359	1,642
Loans and leases:						
Real estate	16,643	3,034	19,677	10,241	981	11,222
Agricultural	134	398	532	27	278	305
Commercial	234	(517)	(283)	212	125	337
Consumer	(199)	121	(78)	(265)	20	(245)
Mortgage warehouse	(860)	585	(275)	(1,512)	625	(887)
Other	(30)	22	(8)	63	(18)	45
Total loans and leases	15,922	3,643	19,565	8,766	2,011	10,777
Total interest earning assets	$15,557	$5,157	$20,714	$10,049	$2,370	$12,419
Liabilities:						
Interest bearing deposits:						
Demand						
NOW	$(50)	$(3)	$(53)	$12	$6	$18
Savings accounts	50	1	51	58	8	66
Money market	60	(4)	56	39	(10)	29
CDAR's	14	(25)	(11)	20	57	77
Certificates of deposit < $100,000	—	—	—	(4)	—	(4)
Certificates of deposit > $100,000	28	294	322	(2)	58	56
Brokered deposits	295	2,533	2,828	128	1,218	1,346
Total interest bearing deposits	—	305	305	—	—	—
Borrowed funds:	397	3,101	3,498	251	1,337	1,588
Borrowed funds:						
Federal funds purchased	(1)	—	(1)	(5)	—	(5)
Repurchase agreements	23	—	23	1	—	1
Short term borrowings	16	122	138	(95)	26	(69)
Long term borrowings	—	—	—	—	—	—
TRUPS	7	356	363	32	353	385
Total borrowed funds	45	478	523	(67)	379	312

Total interest bearing liabilities	442	3,579	4,021	184	1,716	1,900
Net interest income	$15,115	$1,578	$16,693	$9,865	$654	$10,519

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Net interest income in 2018 relative to 2017 reflects a favorable variance of $15.153 million attributable to volume changes, in addition to a favorable rate variance of $1.540 million. The volume variance is due to an increase of $277 million, or 14%, in average interest-earning assets, resulting from the impact of acquisitions and organic growth in loans less a $30 million drop in the average balance of investments. The rate variance is largely the result of a 35 basis point increase in our yield on average earning assets relative to an increase of only 23 basis points in the cost of interest-bearing liabilities. Investment yields have been increasing due to the current rising rate environment, and in response to limited investment portfolio restructuring which took place in the latter part of 2017. Loan yields have risen as a result of the impact of higher short-term index rates on variable-rate loans, and a relatively large volume of new fixed-rate and adjustable-rate loans booked at higher interest rates. Rates paid on non-maturity deposits were about the same for the comparative periods, but the weighted average cost of interest-bearing liabilities went up primarily because of higher rates paid on time deposits (including brokered deposits added in the last half of 2018), overnight borrowings and adjustable-rate trust-preferred securities ("TRUPS"). The Company's variance in net interest income also benefited from the fact that the yield increase on earning assets was applied to a much higher balance than the rate change for interest-bearing liabilities. Nonrecurring interest income totaled $277,000 during 2018 as compared to $736,000 for 2017, for a drop of $459,000. The Company's net interest margin, which is tax-equivalent net interest income as a percentage of average interest-earning assets, was 4.24% for 2018 relative to 4.04% in 2017. Discount accretion on loans from whole-bank acquisitions enhanced our net interest margin by approximately seven basis points in 2018 as compared to five basis points in 2017.

The volume variance calculated for 2017 relative to 2016 was a favorable $9.865 million, due to an increase of $235 million, or 14%, in the average balance of interest-earning assets resulting from the impact of acquisitions and organic growth in loans and investments. There was also a favorable rate variance of $654,000 for 2017 over 2016, again because loan and investment yields increased by more than the cost of interest-bearing liabilities, and because the yield increase on earning assets was applied to a higher balance than the rate change for interest-bearing liabilities. Our net interest margin was up by nine basis points in 2017 relative to 2016.

Provision for Loan and Lease Losses

Credit risk is inherent in the business of making loans. The Company sets aside an allowance for loan and lease losses, a contra-asset account, through periodic charges to earnings which are reflected in the income statement as a provision for loan and lease losses. The Company recorded a loan loss provision of $4.350 million in 2018, as compared to negative loan loss provision of $1.140 million in 2017 and no provision for 2016. The provision for 2018 includes $2.400 million for a large purchased participation loan that was placed on non-accrual status in the third quarter of 2018, and also factors in adjustments to the allowance for loan and lease losses pursuant to our evaluation of overall credit quality, growth in outstanding loan balances, and reserves required for other specifically identified impaired loan balances. The provision reversal in 2017 was made possible by principal recovered on charged-off loan balances, and the zero provision for 2016 was facilitated by the reduction of impaired loan balances, lower loan losses, and tighter underwriting standards for new and renewed loans.

With the loan loss provision recorded in 2018 we were able to maintain our allowance for loan and lease losses at a level that, in Management's judgment, is adequate to absorb probable loan losses related to specifically identified impaired loans as well as probable incurred losses in the remaining loan portfolio. Specifically identifiable and quantifiable loan losses are immediately charged off against the allowance. The Company experienced net loan losses of $3.643 million in 2018, including a $2.400 million loss on the previously-referenced participation loan as the loan was transferred OREO and subsequently sold. The Company recorded net recoveries of $482,000 on charged off balances in 2017, and net loan charge-offs of $722,000 in 2016. Except for the outsized provision required in 2018 for a single loan, our need for reserve replenishment via a loan loss provision has been favorably impacted in recent periods by the following factors: we had net principal recoveries in 2017, which went back into the allowance; all of our acquired loans were booked at their fair values at acquisition, and thus did not initially require a loan loss allowance; most charge-offs were recorded against pre-established reserves, which alleviated what otherwise might have been a need for reserve replenishment; loss rates for most loan types have been declining, thus having a positive impact on general reserves required for performing loans; and, new loans booked during and since the great recession have been underwritten using tighter credit standards than was the case for many legacy loans.

The Company’s policies for monitoring the adequacy of the allowance and determining loan amounts that should be charged off, and other detailed information with regard to changes in the allowance, are discussed in Note 2 to the consolidated financial statements and below under "Allowance for Loan and Lease Losses." The process utilized to establish an appropriate allowance for loan and lease losses can result in a high degree of variability in the Company's loan loss provision, and consequently in our net earnings.

Noninterest Revenue and Operating Expense

The table below sets forth the major components of the Company's noninterest revenue and operating expense for the years indicated, along with relevant ratios:

Non-Interest Income/Expense
(dollars in thousands)

	Year Ended December 31,					
	2018	% of Total	2017	% of Total	2016	% of Total
NON-INTEREST INCOME:						
Service charges on deposit accounts	$12,439	57.69 %	$11,230	51.55 %	$10,151	52.76 %
Checkcard fees	5,878	27.26 %	4,955	22.75 %	4,467	23.22 %
Other service charges and fees	5,219	24.20 %	4,052	18.61 %	3,865	20.09 %
Bank owned life insurance income	591	2.74 %	1,640	7.53 %	994	5.17 %
Gain on sale of securities	2	0.01 %	500	2.30 %	223	1.16 %
Loss on tax credit investment	(2,561)	-11.88 %	(961)	-4.41 %	(944)	-4.91 %
Other	(4)	-0.02 %	363	1.67 %	482	2.51 %
Total non-interest income	21,564	100.00 %	21,779	100.00 %	19,238	100.00 %
As a % of average interest-earning assets		0.98 %		1.13 %		1.14 %
OTHER OPERATING EXPENSES:						
Salaries and employee benefits	36,133	51.61 %	31,506	48.14 %	27,452	47.30 %
Occupancy costs						
Furniture and equipment	2,632	3.76 %	2,674	4.09 %	2,372	4.09 %
Premises	7,663	10.94 %	6,916	10.57 %	5,394	9.29 %
Advertising and promotion costs	2,748	3.92 %	2,514	3.84 %	2,386	4.11 %
Data processing costs	5,015	7.16 %	4,365	6.67 %	3,607	6.21 %
Deposit services costs	5,413	7.73 %	4,426	6.76 %	3,737	6.44 %
Loan services costs						
Loan processing	1,142	1.64 %	1,029	1.57 %	635	1.09 %
Foreclosed assets	(730)	-1.04 %	270	0.41 %	657	1.13 %
Other operating costs						
Telephone and data communications	1,479	2.11 %	1,654	2.53 %	1,552	2.67 %
Postage and mail	997	1.42 %	1,064	1.63 %	997	1.72 %
Other	1,408	2.01 %	1,089	1.67 %	902	1.55 %
Professional services costs						
Legal and accounting	1,932	2.76 %	1,532	2.34 %	1,675	2.89 %
Acquisition costs	449	0.64 %	2,225	3.40 %	2,411	4.15 %
Other professional services costs	1,956	2.79 %	2,266	3.46 %	1,996	3.44 %
Stationery and supply costs	1,387	1.98 %	1,309	2.00 %	1,425	2.45 %
Sundry & tellers	400	0.57 %	602	0.92 %	855	1.47 %
Total other operating expense	$70,024	100.00 %	$65,441	100.00 %	$58,053	100.00 %
As a % of average interest-earning assets		3.18 %		3.40 %		3.43 %
Net non-interest income as a % of average interest-earning assets		-2.20 %		-2.27 %		-2.30 %

Efficiency ratio [1]	60.79 %	65.53 %	67.23 %

[1] Tax Equivalent

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The Company's results reflect a drop of $215,000, or 1%, in total noninterest income in 2018, relative to an increase of $2.541 million, or 13%, in 2017 over 2016. Both 2018 and 2017 include core increases resulting from growth, as discussed in greater detail below, but several items of a nonrecurring nature have also had a significant impact over the past few years. For 2018, nonrecurring noninterest income is comprised primarily of the $1.183 million write-up of our investment in Pacific Coast Bankers Bank ("PCBB") and a $161,000 special dividend received pursuant to our equity investment in the Federal Home Loan Bank of San Francisco ("FHLB"), net of a $915,000 adjustment to accelerate expense amortization associated with tax credit investments (which is netted out of revenue). In 2017, nonrecurring income includes $500,000 in net gains on the sale of investments, $503,000 in life insurance proceeds, and $323,000 in gains from the dissolution of a low-income housing tax credit fund investment, while 2016 includes $223,000 in gains on the sale of investments, $481,000 in life insurance proceeds, and $276,000 in FHLB special dividends. Moreover, while not technically characterized as a nonrecurring item, there were large fluctuations in BOLI income over the last three years, due primarily to varying levels of income on BOLI associated with deferred compensation plans. Total noninterest income was 0.98% of average interest-earning assets in 2018, relative to 1.13% in 2017 and 1.14% in 2016. The ratio has been trending lower due in part to a rising balance of interest-earning assets.

The principal component of the Company's noninterest revenue, service charges on deposit accounts, increased by $1.209 million, or 11%, in 2018 over 2017, and by $1.079 million, or 11%, in 2017 relative to 2016, due to fees earned on a higher number of deposit accounts and additional fees on certain higher-risk commercial accounts. The 2018 variance was also impacted by the reclassification of certain income from other service charges and fees to deposit service charges starting in the third quarter of 2017, with the adjustment boosting service charges on deposits by about $200,000 for 2018 relative to 2017. The Company's ratio of service charge income to average transaction account balances was 1.0% in 2018 and 2017, down slightly from 1.1% in 2016.

The line item immediately following service charges on deposits is checkcard fees, consisting of interchange fees from our customers' use of debit cards for electronic funds transactions. This category increased by $923,000, or 19%, in 2018 over 2017, and by $488,000, or 11%, in 2017 over 2016 as a result of growth in our deposit account base, including the addition of accounts pursuant to acquisitions. Other service charges and fees, which also constitute a relatively large portion of noninterest income, increased by $1.167 million, or 29%, in 2018 over 2017, and by $187,000, or 5%, in 2017 over 2016. The increase for 2018 includes the impact of the $1.183 million write-up of our PCBB investment and the $161,000 special dividend from the FHLB in 2018, offset by $200,000 due to the income reclassification noted in the previous paragraph. The increase in this category in 2017 reflects a stronger volume of fee-generating activities.

BOLI income fell by $1.049 million, or 64%, in 2018 over 2017 but increased by $646,000, or 65%, in 2017 over 2016. BOLI income is derived from two types of policies owned by the Company, namely "separate account" and "general account" life insurance, and the year over year variances are due in large part to fluctuations in income on separate account BOLI. The Company had $6.6 million invested in separate account BOLI at December 31, 2018, which produces income that helps offset expense accruals for deferred compensation accounts the Company maintains on behalf of certain directors and senior officers. Those accounts have returns pegged to participant-directed investment allocations that can include equity, bond, or real estate indices, and are thus subject to gains or losses which often contribute to significant fluctuations in income (and associated expense accruals). Losses on separate account BOLI totaled $381,000 in 2018, relative to gains of $690,000 in 2017 and $151,000 in 2016. This resulted in a negative variance of $1.071 million in 2018 over 2017, and an increase of $539,000 in 2017 over 2016. As noted, gains and losses on separate account BOLI are related to expense accruals or reversals associated with participant gains and losses on deferred compensation balances, thus their net impact on taxable income tends to be minimal. The Company's books also reflect a net cash surrender value of $41.6 million for general account BOLI at year-end 2018. General account BOLI produces income that is used to help offset expenses associated with executive salary continuation plans, director retirement plans and other employee benefits. Interest credit rates on general account BOLI do not change frequently so the income has typically been fairly consistent. While rate reductions and an increase in the cost of insurance for certain policies created downward pressure on general account BOLI income over the past few years, the average income crediting rate improved in 2017 due to the termination of a high-cost policy in late 2016. Furthermore, the Ojai acquisition included over $2 million in BOLI, thus income on general account BOLI reflects small increases for 2018 and 2017.

The Company realized only $2,000 in gains on investments in 2018, but as previously referenced we realized net gains on the sale of investments of $500,000 in 2017 and $223,000 in 2016. The next line item reflects pass-through expenses associated with our investments in low-income housing tax credit funds and other limited partnerships. Those expenses, which are netted out of revenue, increased by $1.600 million, or 166%, in 2018 over 2017, and by $17,000, or 2%, in 2017 relative to 2016. The largest contribution to the unfavorable variance in 2018 over 2017 came from a $915,000 adjustment to accelerate expense amortization on our tax credit investments, to ensure that the book value of each investment does not exceed its projected remaining tax benefits. However, variances in both 2018 and 2017 were also impacted by expense amortization for newer investments and a gain of $323,000 realized in 2017 from the dissolution of one of our earliest tax credit investment funds.

Other noninterest income includes gains and losses on the disposition of assets other than OREO, rent on bank-owned property other than OREO, life insurance proceeds, loan servicing income (net of amortization expense on our servicing asset), and other miscellaneous income. There was a drop of $367,000 in other noninterest income in 2018 relative to 2017, due to nonrecurring life insurance proceeds totaling $503,000 recorded in 2017. The category also declined by $119,000 in 2017 relative to 2016, due to the disposition of certain fixed assets at a loss in 2017. As noted above, life insurance proceeds totaled $503,000 in 2017 relative to $481,000 in 2016, for an immaterial difference.

Total operating expense, or noninterest expense, increased by $4.583 million, or 7%, in 2018 over 2017, and by $7.388 million, or 13%, in 2017 relative to 2016. The increase for 2018 is due primarily to a full year of operating costs associated with the Ojai whole-bank acquisition and a partial year of costs for the Lompoc branch acquisition, offset in part by favorable swings of $1.000 million in net foreclosed asset costs and $698,000 in directors deferred compensation expense (related to the drop in BOLI income). The increase for 2017 is also comprised in large part of ongoing operating costs incidental to our acquisitions and de novo branch expansion. Noninterest expense includes the following items of a nonrecurring nature: for 2018, net foreclosed asset costs of negative $730,000 due to gains on the sale of OREO, and acquisition costs of $449,000; for 2017, acquisition costs of $2.225 million, lending-related costs totaling about $300,000, and net OREO expense of $270,000; and, for 2016, acquisition costs of $2.411 million, net OREO expense of $657,000, and a nonrecurring expense reversal of $173,000 in director retirement plan accruals subsequent to the death of a former director and the payment of split-dollar life insurance proceeds to his beneficiary. Noninterest expense was 3.18% of average earning assets in 2018, relative to 3.40% in 2017 and 3.43% for 2016. The downward trend is due in part to growth in average earning assets, and the ratios were also impacted by OREO gains in 2018 and higher acquisition costs in 2017 and 2016.

The largest component of operating expense, salaries and employee benefits, was up by $4.627 million, or 15%, in 2018 over 2017 and $4.054 million, or 15%, in 2017 over 2016. Personnel costs increased in 2018 due to a full year of costs for employees retained subsequent to our acquisitions in 2017 and offices opened in 2017, staffing costs for the Lompoc branch acquired in 2018, salary adjustments in the normal course of business, and an increase of $593,000, or 23%, in group health insurance costs. The increase for 2017 is due mainly to expenses for employees retained subsequent to our acquisitions, staffing costs for branch offices that commenced operations in 2017, and higher costs for temporary employees and overtime related to the Ojai whole-bank and Woodlake branch acquisitions and system conversions, but also includes salary adjustments in the normal course of business, costs for non-acquisition related staff additions, a relatively large increase in group health insurance costs, and higher equity incentive compensation expense related to stock options. Components of compensation expense that can experience significant variability and are typically difficult to predict include salaries associated with successful loan originations, which are accounted for in accordance with Financial Accounting Standards Board ("FASB") guidelines on the recognition and measurement of non-refundable fees and origination costs for lending activities, and accruals associated with employee deferred compensation plans. Loan origination salaries that were deferred from current expense for recognition over the life of related loans totaled $4.173 million in 2018, $3.854 million for 2017, and $3.430 million for 2016, with the fluctuations due to variability in successful organic loan origination activity. Employee deferred compensation expense accruals totaled only $7,000 for 2018, relative to $217,000 in 2017 and $141,000 in 2016. As noted above in our discussion of BOLI income, employee deferred compensation plan accruals are related to separate account BOLI income and losses, as are directors deferred compensation accruals that are included in "other professional services," and the net income impact of all income/expense accruals related to deferred compensation is usually minimal. Salaries and benefits were 51.61% of total operating expense in 2018, relative to 48.14% in 2017 and 47.30% in 2016. The number of full-time equivalent staff employed by the Company totaled 541 at the end of 2018, 556 at the end of 2017, and 479 at the end of 2016. The reduction in 2018 came from efficiency initiatives implemented toward the end of the year and more open positions, partially offset by staff additions related to the Lompoc branch acquisition. The increase in 2017 over 2016 is due to the addition of former Ojai Community Bank employees and

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Woodlake branch staff, personnel for de novo branches opened in 2017, and certain back office additions deemed necessary to ensure a continued high level of customer service.

Total rent and occupancy expense, including furniture and equipment costs, increased by $705,000, or 7%, in 2018 over 2017, compared to $1.824 million, or 23%, in 2017 over 2016. The increase for 2018 includes the impact of the acquisition and de novo branch offices, and was also due in part to an accrual adjustment that inflated rent expense in 2017. The increase in 2017 was primarily the result of expenses associated with locations added during the year, including certain non-recurring start-up costs associated with outfitting new branches, but it also includes inflationary increases related to other locations and the impact of expense accrual adjustments in 2017.

Advertising and promotion costs were up by $234,000, or 9%, in 2018 over 2017 and $128,000, or 5%, in 2017 over 2016. The increases are mainly the result of marketing efforts targeting our expanded geography, and other promotional expenses associated with opening new branches. Data processing costs increased by $650,000, or 15%, in 2018 over 2017 and $758,000, or 21%, in 2017 compared to 2016. The increase in 2018 is primarily from additional core processing costs and other software costs associated with Bank expansion. The increase in 2017 is from ongoing expenses related to our acquisitions and new branches, but also includes costs associated with an online lending platform that was implemented at the beginning of 2017. Deposit services costs also increased by $987,000, or 22%, in 2018 over 2017 and $689,000, or 18%, in 2017 over 2016. As with data processing costs, much of the increase in deposit costs is the result of ongoing expenses associated with our acquisitions, including operational costs and amortization expense on our core deposit intangible, as well as expenses for other new offices. Deposit costs were further impacted by increases in debit card processing costs due to higher activity levels.

Loan services costs are comprised of loan processing costs, and net costs associated with foreclosed assets. Loan processing costs, which include expenses for property appraisals and inspections, loan collections, demand and foreclosure activities, loan servicing, loan sales, and other miscellaneous lending costs, increased by $113,000, or 11%, in 2018 over 2017 and $394,000, or 62%, in 2017 relative to 2016. The increase in 2018 resulted from a higher level of appraisal, inspection and credit reporting costs incidental to more robust lending activity as well as a $90,000 increase in our reserve for unfunded commitments, but the variance was also favorably impacted by $300,000 in nonrecurring lending costs in 2017, as noted above. The increase in 2017 over 2016 is due primarily to those nonrecurring lending costs, but it also includes costs related to an increase in lending activity. Foreclosed assets costs are comprised of write-downs taken subsequent to reappraisals, OREO operating expense (including property taxes), and losses on the sale of foreclosed assets, net of rental income on OREO properties and gains on the sale of foreclosed assets. Those costs reflect reductions of $1.000 million in 2018 relative to 2017, and $387,000 in 2017 over 2016. The drop for 2018 resulted mainly from a $1.367 million increase in gains on OREO sales, net of a $343,000 increase in OREO write-downs. The decline in 2017 came primarily in lower OREO write-downs relative to 2016.

The “other operating costs” category includes telecommunications expense, postage, and other miscellaneous costs. Telecommunications expense was $175,000 lower in 2018 than in 2017, an 11% decline due to focused expense reduction efforts, but costs increased by $102,000, or 7%, in 2017 relative to 2016 due mainly to expenses associated with branch expansion. Postage expense also dropped by $67,000, or 6%, in 2018 relative to 2017 due to efficiency initiatives implemented in 2018, but increased by $67,000, or 7%, in 2017 over 2016 due mainly to statements and disclosures mailed to an expanding customer base. The “Other” category under other operating costs was up by $319,000, or 29%, in 2018 over 2017 due to higher consulting and training costs, and by $187,000, or 21%, in 2017 over 2016 due primarily to higher travel costs, which rose in connection with our acquisitions and conversions, de novo branches, and increased frequency of offsite meetings.

Legal and accounting costs increased by $400,000, or 26%, in 2018 over 2017, primarily as a result of higher audit and tax costs and higher legal costs associated with collections. The increase in audit and tax costs resulted in part from an expense accrual reversal of $140,000 in 2017, resulting from an accrual carried over from the previous year that was ultimately not needed. Legal and accounting costs declined $143,000, or 9%, in 2017 relative to 2016, since the accrual adjustment in 2017 and lower collections-related legal costs offset increases in other areas. Acquisition costs, or one-time expenses directly attributable to our whole-bank and branch acquisitions, totaled $449,000 in 2018, relative to $2.225 million in 2017 and $2.411 million in 2016. Acquisition costs are comprised primarily of termination fees for core processing contracts and certain other contracts, software conversion costs, financial advisor fees, legal costs, severance and retention amounts paid to employees of the acquired institutions, and the write-off of furniture, fixtures and equipment that were not utilized by the Company.

Other professional services costs include FDIC assessments and other regulatory expenses, directors' costs, and certain insurance costs among other things. This category declined by $310,000, or 14%, in 2018 relative to 2017, but increased by $270,000, or 14%, in 2017 over 2016. The drop in 2018 stems from a favorable swing of $698,000 in director's deferred compensation expense, which more than offset higher FDIC costs and corporate insurance premiums. The increase in 2017 includes higher director's deferred compensation expense, an increase stemming from a nonrecurring reversal of $173,000 in director retirement plan accruals in 2016, and higher stock option expense, partially offset by lower regulatory assessments. As with deferred compensation accruals for employees, directors' deferred compensation expense is related to separate account BOLI income and losses, and the net income impact of all income/expense accruals related to deferred compensation is usually minimal. Directors' deferred compensation expense reflects an expense reversal of $100,000 in 2018 resulting from losses on deferred compensation plans, as compared to expense accruals totaling $598,000 in 2017 and $173,000 in 2016.

Stationery and supply costs increased by $78,000, or 6%, in 2018 over 2017, but fell by $116,000, or 8%, in 2017 compared to 2016. The increase in 2018 reflects expenses associated with Bank expansion. Stationery and supply costs for 2017 also reflect additional expenses for a larger number of branches, but the variance relative to 2016 was favorably impacted by costs associated with the issuance of new debit cards incorporating EMV technology in 2016. Sundry and teller costs reflect reductions of $202,000, or 34% in 2018 as compared to 2017, and $253,000, or 30%, in 2017 relative to 2016 due to reduced debit card losses and lower operations-related losses.

The Company's tax-equivalent overhead efficiency ratio was 60.79% in 2018, relative to 65.52% in 2017 and 67.23% in 2016. The overhead efficiency ratio represents total noninterest expense divided by the sum of fully tax-equivalent net interest and noninterest income, with the provision for loan losses and investment gains/losses excluded from the equation. The ratio was relatively low in 2018 due in part to nonrecurring OREO gains, and it was higher in 2017 and 2016 due in part to non-recurring acquisition costs incurred in those periods.

Income Taxes

Our income tax provision was $9.907 million, or 25% of pre-tax income in 2018, relative to provisions of $13.640 million, or 41% of pre-tax income in 2017 and $8.800 million, or 33% of pre-tax income in 2016. The tax accrual rate dropped in 2018 because of a lower federal income tax rate. The tax accrual rate for 2017 was higher than in 2016 primarily because of the $2.710 million deferred tax asset revaluation charge, but it also reflects higher taxable income relative to available tax credits.

The Company sets aside a provision for income taxes on a monthly basis. The amount of that provision is determined by first applying the Company's statutory income tax rates to estimated taxable income, which is pre-tax book income adjusted for permanent differences, and then subtracting available tax credits. Permanent differences include but are not limited to tax-exempt interest income, BOLI income, and certain book expenses that are not allowed as tax deductions. The Company's investments in state, county and municipal bonds provided $4.060 million in federal tax-exempt income in 2018, $3.711 million in 2017, and $3.009 million in 2016. Moreover, in addition to life insurance proceeds of $503,000 in 2017 and $481,000 in 2016, net increases in the cash surrender value of bank-owned life insurance added $591,000 to tax-exempt income in 2018, $1.640 million in 2017 and $994,000 in 2016.

Our tax credits consist primarily of those generated by investments in low-income housing tax credit funds, and California state employment tax credits. We had a total of $5.9 million invested in low-income housing tax credit funds as of December 31, 2018, which are included in other assets rather than in our investment portfolio. Those investments have generated substantial tax credits over the past few years, with about $632,000 in credits available for the 2018 tax year, $711,000 in tax credits utilized in 2017, and $686,000 in tax credits utilized in 2016. The credits are dependent upon the occupancy level of the housing projects and income of the tenants, and cannot be projected with certainty. Furthermore, our capacity to utilize them will continue to depend on our ability to generate sufficient pre-tax income. We plan to invest in additional tax credit funds in the future, but if the economics of such transactions do not justify continued investments then the level of low-income housing tax credits will taper off in future years until they are substantially utilized by the end of 2028. That means that even if taxable income stayed at the same level through 2028, our tax accrual rate would gradually increase.

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Financial Condition

Assets totaled $2.523 billion at the end of 2018, reflecting an increase of $182 million, or 8%, for the year due primarily to an increase of $174 million, or 11%, in gross loan balances. Deposits were up $128 million, or 6%, while non-deposit borrowings, including junior subordinated debentures, were increased by $43 million, or 66%. Total capital increased by $17 million, or 7%. The major components of the Company's balance sheet are individually analyzed below, along with information on off-balance sheet activities and exposure.

Loan and Lease Portfolio

The Company's loan and lease portfolio represents the single largest portion of invested assets, substantially greater than the investment portfolio or any other asset category, and the quality and diversification of the loan and lease portfolio are important considerations when reviewing the Company's financial condition.

The Selected Financial Data table in Item 6 above reflects the amount of loans and leases outstanding at December 31st for each year from 2018 back to 2014, net of deferred fees and origination costs and the allowance for loan and lease losses. The Loan and Lease Distribution table that follows sets forth by loan type the Company's gross loans and leases outstanding, and the percentage distribution in each category at the dates indicated. The balances for each loan type include nonperforming loans, if any, but do not reflect any deferred or unamortized loan origination, extension, or commitment fees, or deferred loan origination costs. Although not reflected in the loan totals below and not currently comprising a material part of our lending activities, the Company also occasionally originates and sells, or participates out portions of, loans to non-affiliated investors.

Loan and Lease Distribution
(dollars in thousands)

	As of December 31,				
	2018	2017	2016	2015	2014
Real estate:					
1-4 family residential construction	$105,676	$74,256	$32,417	$14,941	$5,858
Other construction/land	109,023	58,779	40,650	37,359	19,908
1-4 family - closed-end	236,825	204,766	137,143	137,356	114,259
Equity lines	56,320	62,590	43,443	44,233	49,717
Multi-family residential	54,877	42,930	31,631	27,222	18,718
Commercial real estate - owner occupied	301,324	263,447	253,535	218,708	218,654
Commercial real estate - non-owner occupied	438,344	379,432	244,198	165,107	132,077
Farmland	151,541	140,516	134,480	133,182	145,039
Total real estate	1,453,930	1,226,716	917,497	778,108	704,230
Agricultural	49,103	46,796	46,229	46,237	27,746
Commercial and industrial	128,220	135,662	123,595	113,207	113,771
Mortgage warehouse lines	91,813	138,020	163,045	180,355	106,021
Consumer loans	8,862	10,626	12,165	14,949	18,885
Total loans and leases	$1,731,928	$1,557,820	$1,262,531	$1,132,856	$970,653
Percentage of Total Loans and Leases					
Real estate:					
1-4 family residential construction	6.10 %	4.77 %	2.57 %	1.32 %	0.60 %
Other construction/land	6.29 %	3.77 %	3.22 %	3.30 %	2.05 %
1-4 family - closed-end	13.67 %	13.14 %	10.86 %	12.12 %	11.77 %
Equity lines	3.25 %	4.02 %	3.44 %	3.90 %	5.12 %
Multi-family residential	3.17 %	2.76 %	2.51 %	2.40 %	1.93 %
Commercial real estate - owner occupied	17.40 %	16.91 %	20.08 %	19.31 %	22.53 %
Commercial real estate - non-owner occupied	25.32 %	24.36 %	19.34 %	14.57 %	13.61 %
Farmland	8.75 %	9.02 %	10.65 %	11.76 %	14.94 %
Total real estate	83.95 %	78.75 %	72.67 %	68.69 %	72.55 %
Agricultural	2.84 %	3.00 %	3.66 %	4.08 %	2.86 %
Commercial and industrial	7.40 %	8.71 %	9.79 %	9.99 %	11.72 %
Mortgage warehouse lines	5.30 %	8.86 %	12.91 %	15.92 %	10.92 %
Consumer loans	0.51 %	0.68 %	0.96 %	1.32 %	1.95 %
	100.00 %	100.00 %	100.00 %	100.00 %	100.00 %

The Company has experienced net growth in loan and lease balances in each of the last five years, despite fluctuations caused by variability in outstanding balances on mortgage warehouse lines, reductions associated with the resolution of impaired loans, weak loan demand in some years, tightened underwriting standards, and intense competition. This growth is due in part to acquisitions, including Santa Clara Valley Bank in 2014, Coast National Bank in 2016 and Ojai Community Bank in 2017, as well as whole loan purchases and participations. Organic loan growth has also been relatively robust in recent periods, particularly with regard to commercial real estate and construction loans.

For 2018, gross loans were up by $174 million, or 11%, due to strong growth in real estate loans net of a $46 million reduction in outstanding balances on mortgage warehouse lines. Total real estate loans increased by $227 million, or 19%, primarily from organic growth, but the increase also includes the first quarter bulk purchase of single-family mortgage loans which had a balance of $11 million at the time of purchase. Agricultural production loans were also up $2 million, or 5%. Commercial loans, however, reflect a net drop of $7 million, or 5%, and outstanding balances on mortgage warehouse lines declined by $46 million, or 33%, as the utilization rate on those lines dropped to 23% at December 31, 2018 from 34% at December 31, 2017. Mortgage lending activity is highly correlated with changes in interest rates and refinancing activity and has historically been subject to significant fluctuations, so no assurance can be provided with regard to our ability to maintain or grow mortgage warehouse balances. Consumer loans also fell by $2 million, or 17%, during 2018.

Management remains focused on organic loan growth, which combined with strong economic activity in some of our markets led to record levels for our pipeline of loans in process of approval in recent periods. However, no assurance can be provided with regard to future net growth in aggregate loan balances since we are still experiencing occasional surges in prepayments in addition to significant fluctuations in mortgage warehouse lending, and the market for top-quality loans remains extremely competitive.

Loan and Lease Maturities

The following table shows the maturity distribution for total loans and leases outstanding as of December 31, 2018, including non-accruing loans, grouped by remaining scheduled principal payments:

Loans and Lease Maturity
(dollars in thousands)

As of December 31, 2018	Three months or less	Three months to twelve months	One to five years	Over five years	Total	Floating rate: due after one year	Fixed rate: due after one year
Real estate	$85,113	$ 97,893	$ 131,018	$1,139,906	$1,453,930	$ 956,625	$ 314,299
Agricultural	5,183	35,124	5,957	2,839	49,103	7,619	1,177
Commercial and industrial	9,798	31,655	41,744	45,023	128,220	34,990	51,777
Mortgage warehouse lines	8,173	61,369	22,271	—	91,813	—	22,271
Consumer loans	955	674	3,659	3,574	8,862	1,140	6,093
Total	$109,222	$ 226,715	$ 204,649	$1,191,342	$1,731,928	$ 1,000,374	$ 395,617

For a comprehensive discussion of the Company’s liquidity position, balance sheet repricing characteristics, and sensitivity to interest rates changes, refer to the “Liquidity and Market Risk” section of this discussion and analysis.

Off-Balance Sheet Arrangements

The Company maintains commitments to extend credit in the normal course of business, as long as there are no violations of conditions established in the outstanding contractual arrangements. Unused commitments to extend credit totaled $782 million at December 31, 2018 and $692 million at December 31, 2017, although it is not likely that all of those commitments will ultimately be drawn down. The relatively large increase during 2018 is due in part to a higher level of construction loans, which fund incrementally rather than immediately at booking, and lower utilization on mortgage warehouse lines. Unused commitments represented approximately 45% of gross loans outstanding at December 31, 2018 and 44% at December 31, 2017. The Company also had undrawn letters of credit issued to customers totaling $9 million at December 31, 2018 and 2017. Off-balance sheet obligations pose potential credit risk to the Company, and a $384,000 reserve for unfunded commitments is reflected as a liability in our consolidated balance sheet at December 31, 2018, up from $334,000 at December 31, 2017. The effect on the Company's revenues, expenses, cash flows and liquidity from the unused portion of the commitments to provide credit cannot be reasonably predicted because there is no guarantee that the lines of credit will ever be used. However, the "Liquidity" section in this Form 10-K outlines resources available to draw upon should we be required to fund a significant portion of unused commitments.

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In addition to unused commitments to provide credit, the Company is utilizing a $95 million letter of credit issued by the Federal Home Loan Bank on the Company's behalf as security for certain deposits and to facilitate certain credit arrangements with the Company's customers. That letter of credit is backed by loans which are pledged to the FHLB by the Company. For more information regarding the Company's off-balance sheet arrangements, see Note 12 to the consolidated financial statements in Item 8 herein.

Contractual Obligations

At the end of 2018, the Company had contractual obligations for the following payments, by type and period due:

Contractual Obligations
(dollars in thousands)

	Payments Due by Period				
	Total	Less Than 1 Year	1-3 Years	3-5 Years	More Than 5 Years
Subordinated debentures	$34,767	$ —	$ —	$ —	$ 34,767
Operating leases	13,003	2,190	5,755	2,452	2,606
Other long-term obligations	3,773	842	1,067	31	1,833
Total	$51,543	$ 3,032	$ 6,822	$ 2,483	$ 39,206

Nonperforming Assets

Nonperforming assets ("NPAs") are comprised of loans for which the Company is no longer accruing interest, and foreclosed assets including mobile homes and OREO. If the Company grants a concession to a borrower in financial difficulty, the loan falls into the category of a troubled debt restructuring ("TDR"), which may be designated as either nonperforming or performing depending on the loan's accrual status.

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The following table presents comparative data for the Company's NPAs and performing TDRs as of the dates noted:

Nonperforming Assets and Performing TDRs
(dollars in thousands)

	As of December 31,				
	2018	2017	2016	2015	2014
Real estate:					
Other construction/land	$82	$77	$558	$457	$3,547
1-4 family - closed-end	799	871	963	2,298	3,042
Equity lines	408	922	1,926	1,770	1,049
Multi-family residential	—	—	—	630	171
Commercial real estate - owner occupied	605	236	1,572	2,325	3,417
Commercial real estate - non-owner occupied	49	123	67	262	7,754
Farmland	1,642	293	39	610	51
TOTAL REAL ESTATE	3,585	2,522	5,125	8,352	19,031
Agricultural	—	—	89	—	—
Commercial and industrial	1,425	1,301	692	710	821
Consumer loans	146	140	459	572	826
TOTAL NONPERFORMING LOANS [(1)]	$5,156	$3,963	$6,365	$9,634	$20,678
Foreclosed assets	1,082	5,481	2,225	3,193	3,991
Total nonperforming assets	$6,238	$9,444	$8,590	$12,827	$24,669
Performing TDRs [(1)]	$11,005	$12,413	$14,182	$12,431	$12,359
Nonperforming loans as a % of total gross loans and leases	0.30 %	0.25 %	0.50 %	0.85 %	2.13 %
Nonperforming assets as a % of total gross loans and leases and foreclosed assets	0.36 %	0.60 %	0.68 %	1.13 %	2.53 %

(1) Performing TDRs are not included in nonperforming loans above, nor are they included in the numerators used to calculate the ratios disclosed in this table.

NPAs totaled $6.2 million, or 0.36% of gross loans and leases plus foreclosed assets at the end of 2018, down from $9.4 million, or 0.60% of gross loans and leases plus foreclosed assets at the end of 2017. NPAs were reduced by $3.2 million, or 34%, during 2018, and the decline is even more dramatic when looking further back in time. This reduction has occurred in response to better economic conditions and our continuous efforts to improve credit quality. Not reflected in the period-end numbers is the addition of a $10 million purchased participation loan to nonperforming loans in August 2018. That loan was written down by a total of $2.4 million, and was ultimately transferred to OREO and sold in the fourth quarter of 2018.

The contraction in NPAs in 2018 includes a drop in foreclosed assets of $4.4 million, but nonperforming loans increased by $1.2 million, or 30%, ending the year with a balance of $5.2 million. Nonperforming loans secured by real estate comprised $3.6 million of total nonperforming loans at December 31, 2018, up by $1.1 million, or 42%, since December 31, 2017. The balance of nonperforming commercial loans also increased by $124,000, or 10%, during 2018, ending the period at $1.4 million. We have no reason to believe that there will be additional material increases in nonperforming real estate or commercial loans in the near term, but no assurance can be provided in that regard. Nonperforming loan balances at December 31, 2018 include $1.4 million in TDRs and other loans that were paying as agreed, but which met the technical definition of nonperforming and were classified as such. We also had $11.0 million in loans classified as performing TDRs for which we were still accruing interest at December 31, 2018, a drop of $1.4 million, or 11%, relative to December 31, 2017. Notes 2 and 4 to the consolidated financial statements provide a more comprehensive disclosure of TDR balances and activity within recent periods.

The balance of foreclosed assets had a carrying value of $1.1 million at December 31, 2018, comprised of 11 properties classified as OREO. At the end of 2017 foreclosed assets totaled $5.5 million, consisting of 13 properties classified as OREO and three mobile homes. The $4.4 million reduction in OREO is due in large part to the sale of a $3.1 million property that was in OREO at Ojai Community Bank prior to the acquisition, but also includes OREO write-downs toaling $439,000 and the sale of other properties. All foreclosed assets are periodically evaluated and written down to their fair value less expected disposition costs, if lower than the then-current carrying value. An action plan is in place for each of our non-accruing loans and foreclosed assets and they are all being actively managed. Collection efforts are continuously pursued for all nonperforming loans, but no assurance can be provided that they will be resolved in a timely manner or that nonperforming balances will not increase.

Allowance for Loan and Lease Losses

The allowance for loan and lease losses, a contra-asset, is established through a provision for loan and lease losses. It is maintained at a level that is considered adequate to absorb probable losses on specifically identified impaired loans, as well as probable incurred losses inherent in the remaining loan portfolio. Specifically identifiable and quantifiable losses are immediately charged off against the allowance; recoveries are generally recorded only when sufficient cash payments are received subsequent to the charge off. Note 2 to the consolidated financial statements provides a more comprehensive discussion of the accounting guidance we conform to and the methodology we use to determine an appropriate allowance for loan and lease losses.

The Company’s allowance for loan and lease losses was $9.8 million, or 0.56% of gross loans at December 31, 2018, relative to $9.0 million, or 0.58% of gross loans at December 31, 2017. The increase in the allowance resulted from the addition of a $4.4 million loan loss provision in 2018, less $3.6 million in net loan charge-offs. Reserves were established for losses inherent in incremental loan balances and unanticipated charge-offs in 2018, including $2.4 million related to the large purchased participation loan already discussed. The net increase in the allowance might have been even larger if not for the following circumstances: many charge-offs were recorded against pre-established reserves, which alleviated what otherwise might have been a need for reserve replenishment; all acquired loans were booked at their fair values, and thus did not initially require a loan loss allowance; loan loss rates have been declining, having a positive impact on general reserves established for performing loans; and, new loans booked during and since the great recession have been underwritten using tighter credit standards than was the case for many legacy loans. The ratio of the allowance to nonperforming loans was 189.10% at December 31, 2018, relative to 228.19% at December 31, 2017 and 152.41% at December 31, 2016. A separate allowance of $384,000 for potential losses inherent in unused commitments is included in other liabilities at December 31, 2018.

The table that follows summarizes the activity in the allowance for loan and lease losses for the periods indicated:

Allowance for Loan and Lease Losses
(dollars in thousands)

	As of and for the years ended December 31,				
Balances:	2018	2017	2016	2015	2014
Average gross loans and leases outstanding during period	$1,625,732	$1,318,909	$1,153,240	$1,027,983	$1,027,983
Gross loans and leases held for investment	$1,731,928	$1,557,820	$1,262,531	$1,132,856	$970,653
Allowance for Loan and Lease Losses:					
Balance at beginning of period	$9,043	$9,701	$10,423	$11,248	$11,677
Provision charged to expense	4,350	(1,140)	—	—	350
Charge-offs					
Real estate:					
1-4 family residential construction	—	—	—	—	—
Other construction/land	4	—	144	73	135
1-4 family - closed-end	5	7	97	224	431
Equity lines	125	58	94	92	828
Multi-family residential	—	—	50	—	—
Commercial real estate - owner occupied	—	36	108	318	171
Commercial real estate - non-owner occupied	2,341	—	469	—	45
Farmland	—	—	—	—	19
TOTAL REAL ESTATE	2,475	101	962	707	1,629
Agricultural	—	154	—	—	124
Commercial and industrial	608	669	344	395	625
Mortgage warehouse lines	—	—	—	—	—
Consumer loans	2,225	2,161	1,905	1,738	1,837
Total	5,308	3,085	3,211	2,840	4,215
Recoveries					
Real estate:					
1-4 family residential construction	—	—	—	—	38
Other construction/land	—	5	467	117	702
1-4 family - closed-end	10	1,959	15	93	317
Equity lines	134	32	17	189	273
Multi-family residential	—	—	—	—	—
Commercial real estate - owner occupied	230	38	35	106	504
Commercial real estate - non-owner occupied	—	201	449	246	79
Farmland	—	—	—	—	—
TOTAL REAL ESTATE	374	2,235	983	751	1,913
Agricultural	22	5	14	81	6
Commercial and industrial	148	310	477	225	801
Mortgage warehouse lines	—	—	—	—	—
Consumer loans	1,121	1,017	1,015	958	716
Total	1,665	3,567	2,489	2,015	3,436
Net loan (recoveries) charge offs	3,643	(482)	722	825	779
Balance	$9,750	$9,043	$9,701	$10,423	$11,248

RATIOS										
Net loan and lease charge-offs to average loans and leases	0.22	%	-0.04	%	0.06	%	0.08	%	0.08	%
Allowance for loan and lease losses to gross loans and leases at end of period	0.56	%	0.58	%	0.77	%	0.92	%	1.16	%
Allowance for loan losses to non-performing loans	189.10	%	228.19	%	152.41	%	108.19	%	54.40	%
Net loan and lease charge-offs to allowance for loan losses at end of period	37.36	%	-5.33	%	7.44	%	7.92	%	6.93	%
Net loan charge-offs to provision for loan and lease losses	83.75	%	42.28	%	—		—		222.57	%

As shown in the table above, the Company recorded a loan loss provision of $4.350 million in 2018, relative to a negative loan loss provision of $1.140 million in 2017 and no provision in 2016. As previously noted, there were net charged off balances totaling $3.643 million in 2018, as compared to $482,000 in net recoveries on previously charged-off balances in 2017 and net loan losses of $722,000 in 2016. Any shortfall in the allowance identified pursuant to our analysis of remaining probable losses is covered by quarter-end. Our allowance for probable losses on specifically identified impaired loans was increased by $854,000, or 74%, during 2018, due to reserves required for additions to nonperforming loans. The allowance for probable losses inherent in non-impaired loans was down by $147,000, or 2%, as a result of continued credit quality improvement. The "Provision for Loan and Lease Losses" section above includes additional details on our provision and its relationship to actual charge-offs.

Provided below is a summary of the allocation of the allowance for loan and lease losses for specific loan categories at the dates indicated. The allocation presented should not be viewed as an indication that charges to the allowance will be incurred in these amounts or proportions, or that the portion of the allowance allocated to a particular loan category represents the total amount available for charge-offs that may occur within that category.

Allocation of Allowance for Loan and Lease Losses
(dollars in thousands)

	As of December 31,														
	2018			2017			2016			2015			2014		
	Amount	%Total [1] Loans		Amount	%Total [1] Loans		Amount	%Total [1] Loans		Amount	%Total [1] Loans		Amount	%Total [1] Loans	
Real Estate	$5,831	83.95	%	$4,786	78.75	%	$3,548	72.67	%	$4,783	68.69	%	$6,243	72.55	%
Agricultural	256	2.84	%	208	3.00	%	209	3.66	%	722	4.08	%	986	2.86	%
Commercial and industrial [2]	2,394	12.70	%	2,772	17.57	%	4,279	22.71	%	2,533	25.91	%	1,944	22.64	%
Consumer loans	1,239	0.51	%	1,231	0.68	%	1,208	0.96	%	1,263	1.32	%	1,765	1.95	%
Unallocated	30	—		46	—		457	—		1,122	—		310	—	
Total	$9,750	100.00	%	$9,043	100.00	%	$9,701	100.00	%	$10,423	100.00	%	$11,248	100.00	%

[1] Represents percentage of loans in category to total loans
[2] Includes mortgage warehouse lines

The Company's allowance for loan and lease losses at December 31, 2018 represents Management's best estimate of probable losses in the loan portfolio as of that date, but no assurance can be given that the Company will not experience substantial losses relative to the size of the allowance. Furthermore, fluctuations in credit quality, changes in economic conditions, updated accounting or regulatory requirements, and/or other factors could induce us to augment or reduce the allowance.

Investments

The Company's investments can at any given time consist of debt securities and marketable equity securities (together, the "investment portfolio"), investments in the time deposits of other banks, surplus interest-earning balances in our Federal Reserve Bank ("FRB") account, and overnight fed funds sold. Surplus FRB balances and fed funds sold to correspondent banks typically represent the temporary investment of excess liquidity. The Company's investments serve several purposes: 1) they provide liquidity to even out cash flows from the loan and deposit activities of customers; 2) they provide a source of pledged assets for securing public deposits, bankruptcy deposits and certain borrowed funds which require collateral; 3) they constitute a large base of assets with maturity and interest rate characteristics that can be changed more readily than the loan portfolio, to better match changes in the deposit base and other funding sources of the Company; 4) they are another interest-earning option for surplus funds when loan demand is light; and 5) they can provide partially tax exempt income. Aggregate investments totaled $562 million, or 22% of total assets at December 31, 2018, compared to $567 million, or 24% of total assets at December 31, 2017.

We had no fed funds sold at the end of the reporting periods, and interest-bearing balances held primarily in our Federal Reserve Bank account totaled $2 million at December 31, 2018 relative to $9 million at December 31,

2017. The Company's investment securities portfolio had a book balance of $560 million at December 31, 2018, reflecting a net increase of $2 million for 2018. The Company carries investments at their fair market values. We currently have the intent and ability to hold our investment securities to maturity, but the securities are all marketable and are classified as "available for sale" to allow maximum flexibility with regard to interest rate risk and liquidity management. The expected average life for bonds in our investment portfolio was 4.1 years and their average effective duration was 3.3 years at December 31, 2018, up slightly from an expected average life of 4.0 years and an average effective duration of 3.1 years at year-end 2017.

The following Investment Portfolio table reflects the amortized cost and fair market values for each primary category of investment securities for the past three years:

Investment Portfolio-Available for Sale
(dollars in thousands)

	As of December 31,					
	2018		2017		2016	
	Amortized Cost	Fair Market Value	Amortized Cost	Fair Market Value	Amortized Cost	Fair Market Value
U.S. government agencies	$15,553	$ 15,212	$21,524	$ 21,326	$26,926	$ 26,468
Mortgage-backed securities	414,208	404,733	399,203	393,802	391,555	387,876
State and political subdivisions	140,181	140,534	140,909	143,201	114,140	114,193
Equity securities	—	—	—	—	500	1,546
Total securities	$569,942	$ 560,479	$561,636	$ 558,329	$533,121	$ 530,083

The net unrealized loss on our investment portfolio, or the amount by which aggregate fair market values fell short of amortized cost, was $9 million at December 31, 2018, an increase of $6 million relative to the net unrealized loss of $3 million at December 31, 2017. The change was caused by the adverse impact of rising market interest rates on fixed-rate bond values. The balance of U.S. Government agency securities in our portfolio declined by $6 million, or 29%, during 2018 due primarily to bond maturities. Mortgage-backed securities increased by $11 million, or 3%, due to bond purchases, net of prepayments in the portfolio and changes in fair market values. Municipal bond balances were down $3 million, or 2%, as maturities/redemptions and declines in market valuations offset the impact of bond purchases. Municipal bonds purchased in recent periods have strong underlying ratings, and all municipal bonds in our portfolio undergo a detailed quarterly review for potential impairment.

Investment securities that were pledged as collateral for Federal Home Loan Bank borrowings, repurchase agreements, public deposits and other purposes as required or permitted by law totaled $217 million at December 31, 2018 and $183 million at December 31, 2017, leaving $343 million in unpledged debt securities at December 31, 2018 and $376 million at December 31, 2017. Securities that were pledged in excess of actual pledging needs and were thus available for liquidity purposes, if needed, totaled $9 million at December 31, 2018 and $40 million at December 31, 2017.

The table below groups the Company's investment securities by their remaining time to maturity as of December 31, 2018, and provides weighted average yields for each segment. Since the actual timing of principal payments may differ from contractual maturities when obligors have the right to prepay principal, maturities for mortgage-backed securities (including collateralized mortgage obligations) were determined by incorporating expected prepayments.

Maturity and Yield of Available for Sale Investment Portfolio
(dollars in thousands)

	December 31, 2018									
	Within One Year		After One But Within Five Years		After Five Years But Within Ten Years		After Ten Years		Total	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
	$497	1.50 %	$14,242	2.14 %	$473	3.49 %	$—	—	$15,212	2.16 %

U.S. government agencies										
Mortgage-backed securities	3,152	2.64 %	382,049	2.38 %	19,532	2.85 %	—	—	404,733	2.40 %
State and political subdivisions	6,579	4.69 %	13,861	4.27 %	36,650	3.47 %	83,444	3.64 %	140,534	3.71 %
Total securities	$10,228		$410,152		$56,655		$83,444		$560,479	

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Cash and Due from Banks

Interest-earning cash balances were discussed above in the “Investments” section, but the Company also maintains a certain level of cash on hand in the normal course of business as well as non-earning deposits at other financial institutions. Our balance of cash and due from banks depends on the timing of collection of outstanding cash items (checks), the amount of cash held at our branches and our reserve requirement, among other things, and is subject to significant fluctuations in the normal course of business. While cash flows are normally predictable within limits, those limits are fairly broad and the Company manages its short-term cash position through the utilization of overnight loans to, and borrowings from, correspondent banks, including the Federal Reserve Bank and the Federal Home Loan Bank. Should a large “short” overnight position persist for any length of time, the Company typically raises money through focused retail deposit gathering efforts or by adding brokered time deposits. If a “long” position is prevalent, we will let brokered deposits or other wholesale borrowings roll off as they mature, or we might invest excess liquidity into longer-term, higher-yielding bonds. The Company’s balance of noninterest earning cash and balances due from correspondent banks totaled $72 million, or 3% of total assets at December 31, 2018, and $61 million, or 3% of total assets at December 31, 2017. The average balance of non-earning cash and due from banks, which is a better measure for ascertaining trends, was $61 million for 2018 relative to an average balance of $53 million in 2017. The increase in the average balance in 2018 is due to the impact of vault cash required for acquired and de novo branches, as well as a larger average volume of cash items in process of collection incidental to an expanding base of deposit customers.

Premises and Equipment

Premises and equipment are stated on our books at cost, less accumulated depreciation and amortization. The cost of furniture and equipment is expensed as depreciation over the estimated useful life of the related assets, and leasehold improvements are amortized over the term of the related lease or the estimated useful life of the improvements, whichever is shorter.

The following premises and equipment table reflects the original cost, accumulated depreciation and amortization, and net book value of fixed assets by major category, for the years noted:

Premises and Equipment
(dollars in thousands)

	As of December 31,								
	2018			2017			2016		
	Cost	Accumulated Depreciation and Amortization	Net Book Value	Cost	Accumulated Depreciation and Amortization	Net Book Value	Cost	Accumulated Depreciation and Amortization	Net Book Value
Land	$5,751	$ —							