SIERRA BANCORP
Form 10-Q
November 06, 2015

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES

EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2015

Commission file number: 000-33063

Sierra Bancorp

(Exact name of Registrant as specified in its charter)

California	33-0937517
(State of Incorporation)	(IRS Employer Identification No)

86 North Main Street, Porterville, California 93257

(Address of principal executive offices) (Zip Code)

(559) 782-4900

(Registrant's telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes R No £

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes R No £

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company.

Large accelerated filer £ Accelerated filer R
Non-accelerated filer £ (Do not check if a smaller reporting company) Smaller Reporting Company £

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes £ No R

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

Common stock, no par value, 13,248,048 shares outstanding as of October 30, 2015

FORM 10-Q

Table of Contents

	Page
Part I - Financial Information	**1**
Item 1. Financial Statements (Unaudited)	1
Consolidated Balance Sheets	1
Consolidated Statements of Income	2
Consolidated Statements of Comprehensive Income	3
Consolidated Statements of Cash Flows	4
Notes to Unaudited Consolidated Financial Statements	5
Item 2. Management's Discussion & Analysis of Financial Condition & Results of Operations	34
Forward-Looking Statements	34
Critical Accounting Policies	34
Overview of the Results of Operations and Financial Condition	35
Earnings Performance	36
Net Interest Income and Net Interest Margin	36
Provision for Loan and Lease Losses	40
Non-interest Income and Non-Interest Expense	41
Provision for Income Taxes	44
Balance Sheet Analysis	44
Earning Assets	44
Investments	44
Loan and Lease Portfolio	45
Nonperforming Assets	47
Allowance for Loan and Lease Losses	48
Off-Balance Sheet Arrangements	50
Other Assets	50
Deposits and Interest-Bearing Liabilities	51
Deposits	51
Other Interest-Bearing Liabilities	52
Non-Interest Bearing Liabilities	52
Liquidity and Market Risk Management	52
Capital Resources	55
Item 3. Qualitative & Quantitative Disclosures about Market Risk	56
Item 4. Controls and Procedures	56
Part II - Other Information	**57**
Item 1. - Legal Proceedings	57

Item 1A. - Risk Factors	57
Item 2. - Unregistered Sales of Equity Securities and Use of Proceeds	57
Item 3. - Defaults upon Senior Securities	57
Item 4. - (Removed and Reserved)	57
Item 5. - Other Information	57
Item 6. - Exhibits	58
Signatures	**59**

PART I - FINANCIAL INFORMATION

Item 1 – Financial Statements

SIERRA BANCORP

CONSOLIDATED BALANCE SHEETS

(dollars in thousands)

	September 30, 2015 (unaudited)	December 31, 2014 (audited)
ASSETS		
Cash and due from banks	$ 45,658	$ 48,405
Interest-bearing deposits in banks	3,330	1,690
Total cash & cash equivalents	48,988	50,095
Securities available for sale	509,600	511,883
Loans and leases:		
Gross loans and leases	1,054,136	970,653
Allowance for loan and lease losses	(10,412)	(11,248)
Deferred loan and lease fees, net	1,950	1,651
Net loans and leases	1,045,674	961,056
Premises and equipment, net	22,177	21,853
Foreclosed assets	3,003	3,991
Company owned life insurance	43,675	42,989
Goodwill	6,908	6,908
Other intangible assets, net	963	1,064
Other assets	36,146	37,481
	$ 1,717,134	$ 1,637,320
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Non-interest bearing	$ 423,449	$ 390,897
Interest bearing	1,005,665	975,798
Total deposits	1,429,114	1,366,695
Federal funds purchased and repurchase agreements	10,115	7,251
Short-term borrowings	41,500	18,200
Long-term borrowings	2,000	6,000
Junior subordinated debentures	30,928	30,928
Other liabilities	16,425	21,155
Total Liabilities	1,530,082	1,450,229

Commitments and contingent liabilities (Note 8)		
Shareholders' equity		
Common stock, no par value; 24,000,000 shares authorized; 13,248,048 and 13,689,181 shares issued and outstanding at September 30, 2015 and December 31, 2014, respectively	62,324	64,153
Additional paid in capital	2,650	2,605
Retained earnings	118,795	116,026
Accumulated other comprehensive income	3,283	4,307
Total shareholders' equity	187,052	187,091
	$ 1,717,134	$ 1,637,320

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

1

SIERRA BANCORP

CONSOLIDATED STATEMENTS OF INCOME

(dollars in thousands, except per share data, unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2015	2014	2015	2014
Interest and dividend income				
Loans and leases, including fees	$ 12,924	$ 11,237	$ 38,124	$ 32,644
Taxable securities	1,847	2,008	6,191	5,709
Tax-exempt securities	746	729	2,202	2,203
Federal funds sold and other	7	4	26	55
Total interest income	15,524	13,978	46,543	40,611
Interest expense				
Deposits	452	503	1,345	1,614
Short-term borrowings	12	6	43	16
Long-term borrowings	2	-	9	-
Subordinated debentures	181	177	533	526
Total interest expense	647	686	1,930	2,156
Net Interest Income	14,877	13,292	44,613	38,455
Provision for loan losses	-	-	-	350
Net interest income after provision for loan losses	14,877	13,292	44,613	38,105
Non-interest income				
Service charges on deposits	2,611	2,214	6,880	6,139
Net gains on sale of securities available-for-sale	108	-	431	287
Other income	1,542	1,571	5,611	5,084
Total non-interest income	4,261	3,785	12,922	11,510
Other operating expense				
Salaries and employee benefits	5,904	5,459	18,924	16,772
Occupancy and equipment	1,834	1,662	5,160	4,700
Other	4,547	4,629	14,412	12,014
Total other operating expense	12,285	11,750	38,496	33,486
Income before taxes	6,853	5,327	19,039	16,129
Provision for income taxes	2,443	1,776	6,335	4,543
Net income	$ 4,410	$ 3,551	$ 12,704	$ 11,586
PER SHARE DATA				
Book value	$ 14.12	$ 13.46	$ 14.12	$ 13.46
Cash dividends	$ 0.11	$ 0.09	$ 0.31	$ 0.25
Earnings per share basic	$ 0.33	$ 0.25	$ 0.94	$ 0.82
Earnings per share diluted	$ 0.33	$ 0.25	$ 0.93	$ 0.81

Average shares outstanding, basic	13,358,895	13,939,152	13,531,370	14,083,649
Average shares outstanding, diluted	13,482,364	14,072,783	13,656,747	14,218,194
Total shareholder equity (in thousands)	$ 187,052	$ 186,240	$ 187,052	$ 186,240
Shares outstanding	13,248,048	13,841,342	13,248,048	13,841,342
Dividends Paid	$ 1,474,639	$ 1,260,823	$ 4,205,218	$ 3,528,478

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

2

SIERRA BANCORP

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(dollars in thousands, unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2015	2014	2015	2014
Net Income	$ 4,410	$ 3,551	$ 12,704	$ 11,586
Other comprehensive income, before tax:				
Unrealized gains on securities:				
Unrealized holding (losses) gains arising during period	1,284	(237)	(1,225)	5,256
Less: reclassification adjustment for gains [1]	(108)	-	(431)	(287)
Other comprehensive (loss) income, before tax	1,176	(237)	(1,656)	4,969
Income tax expense (benefit) related to items of other comprehensive income (loss), net of tax	(494)	97	632	(2,045)
Other comprehensive income (loss) gain	682	(140)	(1,024)	2,924
Comprehensive Income	$ 5,092	$ 3,411	$ 11,680	$ 14,510

[1] Amounts are included in net gains on investment securities available-for-sale on the Consolidated Statements of Income in non-interest revenue. Income tax expense associated with the reclassification adjustment for the three months ended September 30, 2015 and 2014 was $45 thousand and zero respectively. Income tax expense associated with the reclassification adjustment for the nine months ended September 30, 2015 and 2014 was $181 thousand and $118 thousand respectively.

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

SIERRA BANCORP

CONSOLIDATED STATEMENTS OF CASH FLOWS

(dollars in thousands, unaudited)

	Nine months ended September 30, 2015		2014	
Cash flows from operating activities:				
Net income	$	12,704	$	11,586
Adjustments to reconcile net income to net cash provided by operating activities:				
Gain on sales of securities		(431)		(287)
Gain on sales of loans		(6)		(3)
Loss on disposal of fixed assets		62		1
Gain on sale on foreclosed assets		(166)		(531)
Writedowns on foreclosed assets		193		286
Share-based compensation expense		33		57
Provision for loan losses		-		350
Depreciation		1,694		1,569
Net accretion on purchased loans		(634)		-
Net amortization on securities premiums and discounts		5,217		4,925
Decrease (increase) in unearned net loan fees		299		(16)
Increase in cash surrender value of life insurance policies		(686)		(1,001)
		323		108

Proceeds from sale of loans				
Increase in loans held-for-sale	(317	)	-	
Decrease in interest receivable and other assets	3,845		1,923	
(Decrease) increase in other liabilites	(4,730	)	1,756	
Deferred Income Tax (Benefit) provision	(1,182	)	864	
Excess tax benefit from equity based compensation	92		-	
Net cash provided by operating activities	16,310		21,587	
Cash flows from investing activities:				
Maturities of securities available for sale	580		995	
Proceeds from sales/calls of securities available for sale	24,408		11,055	
Purchases of securities available for sale	(97,899	)	(111,425	)
Principal pay downs on securities available for sale	68,753		57,062	
Purchases of FHLB stock	(504	)	(190	)
Net increase in loans receivable, net	(84,776	)	(82,126	)
Purchases of premises and equipment, net	(2,136	)	(2,159	)
Proceeds from sale premises and equipment	56		-	
Proceeds from sales of foreclosed assets	1,454		4,421	
Net cash used in investing activities	(90,064	)	(122,367	)
Cash flows from financing activities:				

Increase in deposits		62,419			48,867	
Increase in borrowed funds		19,300			22,390	
Increase in repurchase agreements		2,864			1,196	
Cash dividends paid		(4,205	)		(3,528	)
Repurchases of common stock		(7,956	)		(7,284	)
Stock options exercised		317			811	
Excess tax benefit from equity based compensation		(92	)		-	
Net cash provided by financing activities		72,647			62,452	
Decrease in cash and due from banks		(1,107	)		(38,328	)
Cash and cash equivalents						
Beginning of period		50,095			78,006	
End of period	$	48,988		$	39,678	

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

4

Sierra Bancorp

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2015

Note 1 – The Business of Sierra Bancorp

Sierra Bancorp (the "Company") is a California corporation headquartered in Porterville, California, and is a registered bank holding company under federal banking laws. The Company was formed to serve as the holding company for Bank of the Sierra (the "Bank"), and has been the Bank's sole shareholder since August 2001. The Company exists primarily for the purpose of holding the stock of the Bank and of such other subsidiaries it may acquire or establish. At the present time, the Company's only other subsidiaries are Sierra Statutory Trust II and Sierra Capital Trust III, which were formed in March 2004 and June 2006, respectively, solely to facilitate the issuance of capital trust pass-through securities ("TRUPS"). Pursuant to the Financial Accounting Standards Board ("FASB") standard on the consolidation of variable interest entities, these trusts are not reflected on a consolidated basis in the Company's financial statements. References herein to the "Company" include Sierra Bancorp and its consolidated subsidiary, the Bank, unless the context indicates otherwise.

The Bank is a California state-chartered bank headquartered in Porterville, California. We offer a full range of retail and commercial banking services primarily in Tulare, Kern, Fresno, and Kings Counties in Central California, and in select markets in Southern California including Ventura County, the Santa Clarita Valley, and the San Fernando Valley. Bank of the Sierra was incorporated in September 1977, and opened for business in January 1978 as a one-branch bank with $1.5 million in capital and eleven employees. Our growth in the ensuing years has primarily been organic, but includes two acquisitions: Sierra National Bank in the year 2000, and Santa Clara Valley Bank ("SCVB") in 2014 (see Note 13 to the financial statements, Recent Developments, for details on the SCVB acquisition). We are now the largest bank headquartered in the South San Joaquin Valley with more than 400 employees, 28 full-service branches, a loan production office and $1.7 billion in assets at September 30, 2015. We have received regulatory approval for another branch in Bakersfield, California which is expected to commence operations in mid-2016, and more recently obtained consent for a branch in Sanger, California which could open in the first quarter of 2016 if approved. In addition to our stand-alone offices the Bank has specialized lending units which include a real estate industries center, an agricultural credit center, and an SBA lending unit. We also operate offsite ATMs at six different non-branch locations. The Bank's deposit accounts are insured by the Federal Deposit Insurance Corporation ("FDIC") up to maximum insurable amounts.

Note 2 – Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in a condensed format, and therefore do not include all of the information and footnotes required by U.S. generally accepted accounting principles ("GAAP") for complete financial statements. The information furnished in these interim statements reflects all adjustments that are, in the opinion of Management, necessary for a fair statement of the results for such period. Such adjustments can generally be considered as normal and recurring unless otherwise disclosed in this Form 10-Q. In preparing the accompanying financial statements, Management has taken subsequent events into consideration and recognized them where appropriate. The results of operations in the interim statements are not necessarily indicative of the results that may be expected for any other quarter, or for the full year. Certain amounts reported for 2014 have been reclassified to be consistent with the reporting for 2015. The interim financial information should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2014, as filed with the Securities and Exchange Commission.

Note 3 – Current Accounting Developments

In January 2014, the FASB issued Accounting Standards Update ("ASU") 2014-01, *Investments—Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Qualified Affordable Housing Projects*, to provide additional flexibility with regard to accounting for investments in qualified affordable housing projects. ASU 2014-01 modifies the conditions that must be met to present the pretax impact and related tax benefits of such investments as a component of income taxes ("net" within income tax expense), to enable more investors to elect to use a net presentation for those investments. Investors that do not qualify for net presentation under the new guidance will continue to account for such investments under the equity method or cost method, which results in losses recognized in pretax income and tax benefits recognized in income taxes ("gross" presentation of investment results). For investments that qualify for the net presentation of investment performance, ASU 2014-01 introduces a "proportional amortization method" that can be elected to amortize the investment basis. If elected, the method is required for all eligible investments in qualified affordable housing projects. ASU 2014-01 also requires enhanced recurring disclosures for all investments in qualified affordable housing projects, regardless of the accounting method used for those investments. It is effective for interim and annual periods beginning after December 15, 2014. The Company adopted the enhanced disclosure requirements of ASU 2014-01 as of the first quarter of 2015, as reflected in Note 10 to the consolidated financial statements, but we continue to account for our low-income housing tax credit investments using the equity method so there has been no impact on our income statement or balance sheet.

In January 2014, the FASB issued ASU 2014-04, *Receivables—Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure*, to resolve diversity in practice with respect to a creditor's reclassification of a collateralized consumer mortgage loan to other real estate owned (OREO). Current US GAAP requires a loan to be reclassified to OREO upon a troubled debt restructuring that is "in substance a repossession or foreclosure", where the creditor receives "physical possession" of the debtor's assets regardless of whether formal foreclosure proceedings take place. The terms "in substance a repossession or foreclosure" and "physical possession" are not defined in US GAAP; therefore, questions have arisen about when a creditor should reclassify a collateralized mortgage loan to OREO. ASU 2014-04 requires a creditor to reclassify a collateralized consumer mortgage loan to real estate property upon obtaining legal title to the real estate collateral, or when the borrower voluntarily conveys all interest in the real estate property to the lender to satisfy the loan through a deed in lieu of foreclosure or similar legal agreement. ASU 2014-04 is effective for public business entities for interim and annual periods beginning after December 15, 2014. It was adopted by the Company for the first quarter of 2015, without any impact on our financial statements or operations.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*. This ASU is the result of a joint project initiated by the FASB and the International Accounting Standards Board (IASB) to clarify the principles for recognizing revenue, and to develop a common revenue standard and disclosures for U.S. and international accounting standards that would: (1) remove inconsistencies and weaknesses in revenue requirements; (2) provide a more robust framework for addressing revenue issues; (3) improve comparability of revenue recognition practices across entities, industries, jurisdictions, and capital markets; (4) provide more useful information to users of financial statements through improved disclosure requirements; and (5) simplify the preparation of financial statements by reducing the number of requirements to which an entity must refer. The guidance affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets. The core principle is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance provides steps to follow to achieve the core principle. An entity should disclose sufficient information to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. Qualitative and quantitative information is required with regard to contracts with customers, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract. This ASU was originally scheduled to become effective for reporting periods beginning after December 15, 2016. However, subsequent guidance from the FASB issued in August 2015 delayed the effective date by a year, to annual reporting periods beginning after December 15, 2017, including interim periods therein, with early adoption permitted for reporting periods beginning after December 15, 2016. The Company does not expect to adopt this guidance early and is currently evaluating the potential effects of the guidance on its financial statements and disclosures.

In June 2014, the FASB issued ASU 2014-11, *Transfers and Servicing (Topic 860), Repurchase-to-Maturity Transactions,*

Repurchase Financings, and Disclosures. This ASU aligns the accounting for repurchase-to-maturity transactions and repurchase agreements executed as repurchase financings with the accounting for other more typical repurchase agreements, by requiring that all of these transactions be accounted for as secured borrowings. The guidance eliminates sale accounting for repurchase-to-maturity transactions and supersedes the guidance under which a transfer

of a financial asset and a contemporaneous repurchase financing could be accounted for on a combined basis as a forward agreement, which has resulted in off-balance-sheet accounting. ASU 2014-11 requires a new disclosure for transactions economically similar to repurchase agreements in which the transferor retains substantially all of the exposure to the economic return on the transferred financial assets throughout the term of the transaction. It also requires expanded disclosures about the nature of collateral pledged in repurchase agreements and similar transactions accounted for as secured borrowings. ASU 2014-11 is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. The Company has not entered into any repurchase transactions in recent periods, and any such transactions executed by the Company in the future will likely be typical in nature (i.e., not repurchase-to-maturity transactions or repurchase agreements executed as a repurchase financing) and will thus be accounted for as secured borrowings. As such, ASU 2014-11 did not have an impact on the Company’s consolidated financial statements upon adoption, and is not expected to have any impact in future periods.

In June 2014 the FASB issued ASU 2014-12, *Compensation–Stock Compensation (Topic 718)*, which amended existing guidance related to the accounting for share-based payments when the terms of an award provide that a performance target can be achieved after the requisite service period. These amendments require that a performance target be treated as a "performance condition" if it affects vesting and can be achieved after the requisite service period. To account for such awards, a reporting entity should apply existing guidance in Topic 718 as it relates to awards with performance conditions that affect vesting. The total amount of compensation cost recognized during and after the requisite service period should reflect the number of awards that are expected to vest, and should be adjusted to reflect those awards that ultimately vest. The requisite period ends when the employee can cease rendering service and still be eligible to vest in the award if the performance target is achieved. ASU 2014-12 is effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. It will be adopted by the Company for the first quarter of 2016, and we do not expect any impact upon our financial statements or operations upon adoption.

In August 2014 the FASB issued ASU 2014-14, *Receivables–Troubled Debt Restructurings by Creditors (Subtopic 310-40), Classification of Certain Government-Guaranteed Mortgage Loans upon Foreclosure,* which amended existing guidance related to the classification of certain government-guaranteed mortgage loans, including those guaranteed by the FHA and the VA, upon foreclosure. It requires that a mortgage loan be derecognized and a separate "other receivable" be recognized upon foreclosure if the following conditions are met: 1) the loan has a government guarantee that is not separable from the loan before foreclosure; 2) at the time of foreclosure, the creditor has the intent to convey the real estate property to the guarantor and make a claim on the guarantee, and the creditor has the ability to recover under that claim; and 3) at the time of foreclosure, any amount of the claim that is determined on the basis of the fair value of the real estate is fixed. Upon foreclosure, the separate other receivable should be measured based on the amount of the loan balance (principal and interest) expected to be recovered from the guarantor. ASU 2014-14 is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. It was adopted by the Company for the first quarter of 2015 with no impact on our financial statements or operations.

In April 2015 the FASB issued ASU 2015-03, *Interest – Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs*, to simplify the presentation of debt issuance costs related to a recognized debt liability by reflecting those costs as a direct deduction from the carrying amount of debt liability, consistent with debt discounts. ASU 2015-15 was subsequently issued in August 2015 to clarify the SEC staff's position on presenting and measuring debt issuance costs incurred in connection with line-of-credit arrangements. ASU 2015-03, as modified by ASU 2015-15, is effective for interim and annual periods beginning after December 15, 2015. Early adoption is permitted if the guidance is applied as of the beginning of the annual period of adoption. We do not expect the adoption of this guidance to have a material effect on our consolidated financial statements.

Note 4 – Supplemental Disclosure of Cash Flow Information

During the nine months ended September 30, 2015 and 2014, cash paid for interest due on interest-bearing liabilities was $1.957 million and $2.219 million, respectively. There was $6.390 million in cash paid for income taxes during the nine months ended September 30, 2015, and $160,000 in cash paid for income taxes for the nine months ended September 30, 2014. Assets totaling $1.004 million and $184,000 were acquired in settlement of loans for the nine months ended September 30, 2015 and September 30, 2014, respectively. We received $1.454 million in cash from the sale of foreclosed assets during the first nine months of 2015 relative to $4.421 million during the first nine months of 2014, which represents sales proceeds less loans (if any) extended to finance such sales.

Note 5 – Share Based Compensation

The 2007 Stock Incentive Plan (the “2007 Plan”) was adopted by the Company in 2007. Our 1998 Stock Option Plan (the “1998 Plan”) was concurrently terminated, although options to purchase 50,200 shares that were granted under the 1998 Plan were still outstanding as of September 30, 2015 and remain unaffected by that plan’s termination. The 2007 Plan provides for the issuance of both “incentive” and “nonqualified” stock options to officers and employees, and of “nonqualified” stock options to non-employee directors of the Company. The 2007 Plan also provides for the potential issuance of restricted stock awards to these same classes of eligible participants, on such terms and conditions as are established at the discretion of the Board of Directors or the Compensation Committee. The total number of shares of the Company’s authorized but unissued stock reserved for issuance pursuant to awards under the 2007 Plan was initially 1,500,000 shares, although the number remaining available for grant had declined to 785,300 at September 30, 2015. The dilutive impact of stock options outstanding is discussed below in Note 6, Earnings per Share. No restricted stock awards have been issued by the Company.

Pursuant to FASB's standards on stock compensation, the value of each option granted is reflected in our income statement as employee compensation or directors' expense by amortizing the value over the vesting period of such option or by expensing it as of the grant date for immediately vested options. The Company is utilizing the Black-Scholes model to value stock options, and the "multiple option" approach is used to allocate the resulting valuation to actual expense. Under the multiple option approach an employee's options for each vesting period are separately valued and amortized, which appears to be the preferred method for option grants with graded vesting. A pre-tax charge of $14,000 was reflected in the Company's income statement during the third quarter of 2015 and $24,000 was charged during the third quarter of 2014, as expense related to stock options. For the first nine months, the charges totaled $33,000 in 2015 and $57,000 in 2014.

Note 6 – Earnings per Share

The computation of earnings per share, as presented in the Consolidated Statements of Income, is based on the weighted average number of shares outstanding during each period. There were 13,358,895 weighted average shares outstanding during the third quarter of 2015, and 13,939,152 during the third quarter of 2014. There were 13,531,370 weighted average shares outstanding during the first nine months of 2015, and 14,083,649 during the first nine months of 2014.

Diluted earnings per share include the effect of the potential issuance of common shares, which for the Company is limited to shares that would be issued on the exercise of "in-the-money" stock options. The dilutive effect of options outstanding was calculated using the treasury stock method, excluding anti-dilutive shares and adjusting for unamortized expense and windfall tax benefits. For the third quarter and first nine months of 2015 the dilutive effect of options outstanding calculated under the treasury stock method totaled 123,469 and 125,377, respectively, which were added to basic weighted average shares outstanding for purposes of calculating diluted earnings per share. Likewise, for the third quarter and first nine months of 2014 shares totaling 133,631 and 134,545, respectively, were added to basic weighted average shares outstanding in order to calculate diluted earnings per share.

Note 7 – Comprehensive Income

As presented in the Consolidated Statements of Comprehensive Income, comprehensive income includes net income and other comprehensive income. The Company's only source of other comprehensive income is unrealized gains and losses on available-for-sale investment securities. Gains or losses on investment securities that were realized and reflected in net income of the current period, which had previously been included in other comprehensive income as unrealized holding gains or losses in the period in which they arose, are considered to be reclassification adjustments that are excluded from other comprehensive income in the current period.

Note 8 – Financial Instruments with Off-Balance-Sheet Risk

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business. Those financial instruments currently consist of unused commitments to extend credit and standby letters of credit. They involve, to varying degrees, elements of risk in excess of the amount recognized in the balance sheet. The Company's exposure to credit loss in the event of nonperformance by counterparties for commitments to extend credit and letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and issuing letters of credit as it does for originating loans included on the balance sheet. The following financial instruments represent off-balance-sheet credit risk (dollars in thousands):

	September 30, 2015	December 31, 2014
Commitments to extend credit	$ 370,787	$ 366,909
Standby letters of credit	$ 16,881	$ 14,389

Commitments to extend credit consist primarily of the unused or unfunded portions of the following: home equity lines of credit; commercial real estate construction loans, where disbursements are made over the course of construction; commercial revolving lines of credit; mortgage warehouse lines of credit; unsecured personal lines of credit; and formalized (disclosed) deposit account overdraft lines. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many commitments are expected to expire without being drawn upon, the unused portions of committed amounts do not necessarily represent future cash requirements. Standby letters of credit are generally unsecured and are issued by the Company to guarantee the performance of a customer to a third party, and the credit risk involved in issuing letters of credit is essentially the same as the risk involved in extending loans to customers.

The Company is also utilizing a letter of credit in the amount of $107 million issued by the Federal Home Loan Bank on the Company's behalf as security for certain deposits. That letter of credit is backed by loans which are pledged to the FHLB by the Company.

Note 9 – Fair Value Disclosures and Reporting, the Fair Value Option and Fair Value Measurements

FASB's standards on financial instruments, and on fair value measurements and disclosures, require all entities to disclose in their financial statement footnotes the estimated fair values of financial instruments for which it is practicable to estimate fair values. In addition to disclosure requirements, FASB's standard on investments requires that our debt securities which are classified as available for sale and our equity securities that have readily determinable fair values be measured and reported at fair value in our statement of financial position. Certain impaired loans are also reported at fair value, as explained in greater detail below, and foreclosed assets are carried at the lower of cost or fair value. FASB's standard on financial instruments permits companies to report certain other financial assets and liabilities at fair value, but we have not elected the fair value option for any of those financial instruments.

Fair value measurement and disclosure standards also establish a framework for measuring fair values. Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability, in an orderly transaction between market participants on the measurement date. Further, the standards establish a fair value hierarchy that encourages an entity to maximize the use of observable inputs and limit the use of unobservable inputs when measuring fair values. The standards describe three levels of inputs that may be used to measure fair values:

- Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

- Level 2: Significant observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, and other inputs that are observable or can be corroborated by observable market data.

- Level 3: Significant unobservable inputs that reflect a company's own assumptions about the factors that market participants would likely consider in pricing an asset or liability.

Fair value estimates are made at a specific point in time based on relevant market data and information about the financial instruments. The estimates do not reflect any premium or discount that could result from offering the Company's entire holdings of a particular financial instrument for sale at one time, nor do they attempt to estimate the value of anticipated future business related to the instruments. In addition, the tax ramifications related to realized

gains and losses could have a significant effect on fair value estimates but have not been considered in any estimates. Because no active market exists for a significant portion of our financial instruments, fair value disclosures are based on judgments regarding current economic conditions, risk characteristics of various financial instruments and other factors. The estimates are subjective and involve uncertainties and matters of significant judgment, and therefore cannot be determined with precision. Changes in assumptions could significantly alter the fair values presented. The following methods and assumptions were used by the Company to estimate the fair value of its financial instruments disclosed at September 30, 2015 and December 31, 2014:

- Cash and cash equivalents and fed funds sold: The carrying amount is estimated to be fair value.

- Investment securities: Fair values are determined by obtaining quoted prices on nationally recognized securities exchanges or by matrix pricing, which is a mathematical technique used widely in the industry to value debt securities by relying on their relationship to other benchmark quoted securities when quoted prices for specific securities are not readily available.

- Loans and leases: For variable-rate loans and leases that re-price frequently with no significant change in credit risk or interest rate spread, fair values are based on carrying values. Fair values for other loans and leases are estimated by discounting projected cash flows at interest rates being offered at each reporting date for loans and leases with similar terms, to borrowers of comparable creditworthiness. The carrying amount of accrued interest receivable approximates its fair value.

- Loans held for sale: Since loans designated by the Company as available-for-sale are typically sold shortly after making the decision to sell them, realized gains or losses are usually recognized within the same period and fluctuations in fair values are not relevant for reporting purposes. If available-for-sale loans are on our books for an extended period of time, the fair value of those loans is determined using quoted secondary-market prices.

- Collateral-dependent impaired loans: Collateral-dependent impaired loans are carried at fair value when it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the original loan agreement and the loan has been written down to the fair value of its underlying collateral, net of expected disposition costs where applicable.

- Cash surrender value of life insurance policies: Fair values are based on net cash surrender values at each reporting date.

- Investments in, and capital commitments to, limited partnerships: The fair values of our limited partner investments in low-income housing tax credit funds and other limited partnership investments are estimated using quarterly indications of value provided by the general partners. The fair values of undisbursed capital commitments are assumed to be the same as their book values.

- Other investments: Certain investments for which no secondary market exists are carried at cost and the carrying amount for those investments typically approximates their estimated fair value, unless an impairment analysis indicates the need for adjustments.

- Deposits: Fair values for non-maturity deposits are equal to the amount payable on demand at the reporting date, which is the carrying amount. Fair values for fixed-rate certificates of deposit are estimated using a cash flow analysis, discounted at interest rates being offered at each reporting date by the Bank for certificates with similar remaining maturities. The carrying amount of accrued interest payable approximates its fair value.

- Short-term borrowings: Current carrying amounts are used as an approximation of fair values for federal funds purchased, overnight advances from the Federal Home Loan Bank ("FHLB"), borrowings under repurchase agreements, and other short-term borrowings maturing within ninety days of the reporting dates. Fair values of other short-term borrowings are estimated by discounting projected cash flows at the Company's current incremental borrowing rates for similar types of borrowing arrangements.

- Long-term borrowings: Fair values are estimated using projected cash flows discounted at the Company's current incremental borrowing rates for similar types of borrowing arrangements.

- Subordinated debentures: Fair values are determined based on the current market value for like instruments of a similar maturity and structure.

- Commitments to extend credit and letters of credit: If funded, the carrying amounts for currently unused commitments would provide an equivalent measure of fair values for the newly created financial assets at the funding date. However, because of the high degree of uncertainty with regard to whether or not those commitments will ultimately be funded, fair values for loan commitments and letters of credit in their current undisbursed state cannot reasonably be estimated, and only notional values are disclosed in the table below.

10

Estimated fair values for the Company's financial instruments are as follows, as of the dates noted:

Fair Value of Financial Instruments
(dollars in thousands, unaudited)

	September 30, 2015				
		Estimated Fair Value			
	Carrying Amount	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Financial assets:					
Cash and cash equivalents	$48,988	$48,988	$-	$ -	$48,988
Investment securities available for sale	509,600	1,296	508,304	-	509,600
Loans and leases, net held for investment	1,035,731	-	1,056,516	-	1,056,516
Collateral dependent impaired loans	9,943	-	9,943	-	9,943
Cash surrender value of life insurance policies	43,675	-	43,675	-	43,675
Other investments	7,546	-	7,546	-	7,546
Investment in limited partnership	6,432	-	6,432	-	6,432
Accrued interest receivable	5,662	-	5,662	-	5,662
Financial liabilities:					
Deposits:					
Noninterest-bearing	$423,449	$423,449	$-	$ -	$423,449
Interest-bearing	1,005,665	-	1,005,827	-	1,005,827
Fed funds purchased and repurchase agreements	10,115	-	10,115	-	10,115
Short-term borrowings	41,500	-	41,500	-	41,500
Long-term borrowings	2,000	-	2,004	-	2,004
Subordinated debentures	30,928	-	12,008	-	12,008
Limited partnership capital commitment	795	-	795	-	795
Accrued interest payable	115	-	115	-	115

	Notional Amount
Off-balance-sheet financial instruments:	
Commitments to extend credit	$370,787
Standby letters of credit	16,881

December 31, 2014				
	Estimated Fair Value			
Carrying Amount	Quoted Prices in	Significant Observable	Significant Unobservable	Total

		Active Markets for Identical Assets (Level 1)	Inputs (Level 2)	Inputs (Level 3)	
Financial assets:					
Cash and cash equivalents	$50,095	$50,095	$ -	$ -	$50,095
Investment securities available for sale	511,883	2,222	509,661	-	511,883
Loans and leases, net held for investment	956,265	-	966,599	-	966,599
Collateral dependent impaired loans	4,791	-	4,791	-	4,791
Cash surrender value of life insurance policies	42,989	-	42,989	-	42,989
Other Investments	7,042	-	7,042	-	7,042
Investment in limited partnership	7,276	-	7,276	-	7,276
Accrued interest receivable	5,852	-	5,852	-	5,852
Financial liabilities:					
Deposits:					
Noninterest-bearing	$390,897	$390,897	$ -	$ -	$390,897
Interest-bearing	975,798	-	976,002	-	976,002
Fed funds purchased and repurchase agreements	7,251	-	7,251	-	7,251
Short-term borrowings	18,200	-	18,200	-	18,200
Long-term borrowings	6,000	-	6,000	-	6,000
Subordinated debentures	30,928	-	11,428	-	11,428
Limited partnership capital commitment	914	-	914	-	914
Accrued interest payable	137	-	137	-	137

	Notional Amount
Off-balance-sheet financial instruments:	
Commitments to extend credit	$366,909
Standby letters of credit	14,389

11

For financial asset categories that were actually reported at fair value as of September 30, 2015 and December 31, 2014, the Company used the following methods and significant assumptions:

- Investment securities: Fair values are determined by obtaining quoted prices on nationally recognized securities exchanges or by matrix pricing, which is a mathematical technique used widely in the industry to value debt securities by relying on their relationship to other benchmark quoted securities.

- Collateral-dependent impaired loans: Collateral-dependent impaired loans are carried at fair value when it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the original loan agreement and the loan has been written down to the fair value of its underlying collateral, net of expected disposition costs where applicable.

- Foreclosed assets: Repossessed real estate (known as other real estate owned, or "OREO") and other foreclosed assets are carried at the lower of cost or fair value. Fair value is the appraised value less expected selling costs for OREO and some other assets such as mobile homes, and fair values for any other foreclosed assets are represented by estimated sales proceeds as determined using reasonably available sources. Foreclosed assets for which appraisals can be feasibly obtained are periodically measured for impairment using updated appraisals. Fair values for other foreclosed assets are adjusted as necessary, subsequent to a periodic re-evaluation of expected cash flows and the timing of resolution. If impairment is determined to exist, the book value of a foreclosed asset is immediately written down to its estimated impaired value through the income statement, thus the carrying amount is equal to the fair value and there is no valuation allowance.

Assets reported at fair value on a recurring basis are summarized below:

Fair Value Measurements - Recurring

(dollars in thousands, unaudited)

	Fair Value Measurements at September 30, 2015, using				
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total	Realized Gain/(Loss)
Investment securities					
US Government agencies	$ -	$ 29,741	$ -	$ 29,741	$ -
Mortgage-backed securities	-	377,308	-	377,308	-
State and poltical subdivisions	-	101,255	-	101,255	-
Other securities	1,296	-	-	1,296	-
Total available-for-sale securities	$ 1,296	$ 508,304	$ -	$ 509,600	$ -

	Fair Value Measurements at December 31, 2014, using				
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total	Realized Gain/(Loss)
Investment securities					
US Government agencies	$ -	$ 27,270	$ -	$ 27,270	$ -
Mortgage-backed securities	-	381,442	-	381,442	-
State and poltical subdivisions	-	100,949	-	100,949	-
Other securities	2,222	-	-	2,222	-
Total available-for-sale securities	$ 2,222	$ 509,661	$ -	$ 511,883	$ -

Assets reported at fair value on a nonrecurring basis are summarized below:

Fair Value Measurements - Nonrecurring

(dollars in thousands, unaudited)

	Fair Value Measurements at September 30, 2015, using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Collateral dependent impaired loans	$ -	$ 9,943	$ -	$ 9,943
Foreclosed assets	$ -	$ 3,003	$ -	$ 3,003

	Fair Value Measurements at December 31, 2014, using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Collateral dependent impaired loans	$ -	$ 4,791	$ -	$ 4,791
Foreclosed assets	$ -	$ 3,991	$ -	$ 3,991

The table above includes collateral-dependent impaired loan balances for which a specific reserve has been established or on which a write-down has been taken. Information on the Company's total impaired loan balances and specific loss reserves associated with those balances is included in Note 11 below, and in Management's Discussion and Analysis of Financial Condition and Results of Operation in the "Nonperforming Assets" and "Allowance for Loan and Lease Losses" sections.

The unobservable inputs are based on Management's best estimates of appropriate discounts in arriving at fair market value. Increases or decreases in any of those inputs could result in a significantly lower or higher fair value measurement. For example, an increase or decrease in actual loss rates would have a directionally opposite change in the calculation of the fair value of unsecured impaired loans.

Note 10 – Investments

Investment Securities

Although the Company currently has the intent and the ability to hold the securities in its investment portfolio to maturity, 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. Pursuant to FASB’s guidance on accounting for debt and equity securities, available for sale securities are carried on the Company’s financial statements at their estimated fair market values, with monthly tax-effected “mark-to-market” adjustments made vis-à-vis accumulated other comprehensive income in shareholders’ equity.

Amortized Cost And Estimated Fair Value

The amortized cost and estimated fair value of investment securities available-for-sale are as follows

(dollars in thousands, unaudited):

	September 30, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
US Government agencies	$29,360	$ 389	$ (8)	$ 29,741
Mortgage-backed securities	374,966	3,425	(1,083)	377,308
State and poltical subdivisions	98,951	2,574	(270)	101,255
Other securities	659	637	-	1,296
Total investment securities	$503,936	$ 7,025	$ (1,361)	$ 509,600

	December 31, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
US Government agencies	$26,959	$ 334	$ (23)	$ 27,270
Mortgage-backed securities	378,339	4,299	(1,196)	381,442
State and political subdivisons	98,056	3,093	(200)	100,949
Other securities	1,210	1,012	-	2,222
Total investment securities	$504,564	$ 8,738	$ (1,419)	$ 511,883

At September 30, 2015 and December 31, 2014, the Company had 167 securities and 134 securities, respectively, with unrealized losses. Management has evaluated those securities as of the respective dates, and does not believe that any of the associated unrealized losses are other than temporary. Gross unrealized losses on our investment securities as of the indicated dates are disclosed in the table below, categorized by investment type and by the duration of time that loss positions on individual securities have continuously existed (over or under twelve months).

Investment Portfolio - Unrealized Losses
(dollars in thousands, unaudited)

	September 30, 2015			
	Less than twelve months		Twelve months or more	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
US Government agencies	$(8)	$1,719	$ -	$ -
Mortgage-backed securities	(735)	121,574	(348)	36,331
State and political subdivisions	(162)	18,004	(108)	5,081
Total	$(905)	$141,297	$ (456)	$ 41,412

	December 31, 2014			
	Less than twelve months		Twelve months or more	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
US Government agencies	$(23)	$ 3,485	$ -	$ -
Mortgage-backed securities	(564)	84,004	(632)	51,982
State and political subdivisions	(31)	7,738	(169)	9,045
Total	$(618)	$ 95,227	$ (801)	$ 61,027

The table below summarizes the Company's gross realized gains and losses as well as gross proceeds from the sales of securities, for the periods indicated:

Investment Portfolio - Realized Gains/(Losses)

(dollars in thousands, unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2015	2014	2015	2014
Proceeds from sales, calls and maturities of securities available	$ 198	$ -	$ 24,988	$ 12,050

for sale				
Gross gains on sales, calls and maturities of securities available for sale	$ 108	$ -	$ 630	$ 289
Gross losses on sales, calls and maturities of securities available for sale	-	-	(199)	(2)
Net gains on sale of securities available for sale	$ 108	$ -	$ 431	$ 287

The amortized cost and estimated fair value of investment securities available-for-sale at September 30, 2015 and December 31, 2014 are shown below, grouped by the remaining time to contractual maturity dates. The expected life of investment securities may not be consistent with contractual maturity dates, since the issuers of the securities could have the right to call or prepay obligations with or without penalties.

16

Estimated Fair Value of Contractual Maturities

(dollars in thousands, unaudited)	September 30, 2015	
	Amortized Cost	Fair Value
Maturing within one year	$4,119	$4,160
Maturing after one year through five years	244,792	247,764
Maturing after five years through ten years	58,634	59,743
Maturing after ten years	50,736	51,444
Investment securities not due at a single maturity date:		
U.S Government agencies collateralized by mortgage obligations	144,996	145,193
Other securities	659	1,296
	$503,936	$509,600

	December 31, 2014	
	Amortized Cost	Fair Value
Maturing within one year	$686	$694
Maturing after one year through five years	222,081	225,415
Maturing after five years through ten years	97,949	99,583
Maturing after ten years	54,531	55,705
Investment securities not due at a single maturity date:		
U.S Government agencies collateralized by mortgage obligations	128,107	128,264
Other securities	1,210	2,222
	$504,564	$511,883

At September 30, 2015, the Company’s investment portfolio included securities issued by 279 different government municipalities and agencies located within 27 states with a fair value of $101.3 million. The largest exposure to any single municipality or agency was a $1.1 million (fair value) refunding bond issued by the Columbia River People’s Utility District, to be repaid by future utility revenue.

The Company’s investments in bonds issued by states, municipalities and political subdivisions are evaluated in accordance with Supervision and Regulation Letter 12-15 issued by the Board of Governors of the Federal Reserve System, “Investing in Securities without Reliance on Nationally Recognized Statistical Rating Organization Ratings,” and other regulatory guidance. Credit ratings are considered in our analysis only as a guide to the historical default rate associated with similarly-rated bonds. There have been no significant differences in our internal analyses compared with the ratings assigned by the third party credit rating agencies.

The following table summarizes the amortized cost and fair values of general obligation and revenue bonds in the Company’s investment securities portfolio at the indicated dates, identifying the state in which the issuing municipality or agency operates for our largest geographic concentrations:

<u>Revenue and General Obligation Bonds by Location</u>

dollars in thousands, unaudited	September 30, 2015		December 31, 2014	
	Amortized Cost	Fair Market Value	Amortized Cost	Fair Market Value
General obligation bonds				
State of issuance				
California	$ 20,023	$ 21,110	$ 20,078	$ 21,288
Texas	14,718	14,908	14,489	14,675
Illinois	10,014	10,089	8,272	8,394
Ohio	8,254	8,317	7,456	7,555
Washington	5,920	6,067	5,966	6,126
Utah	954	976	956	984
Other states	22,618	23,036	21,253	21,832
Total General Obligation Bonds	82,501	84,503	78,470	80,854
Revenue bonds				
State of issuance				
Utah	4,437	4,469	3,769	3,834
Texas	3,744	3,845	3,273	3,387
California	1,003	1,031	2,174	2,233
Washington	1,370	1,389	1,167	1,197
Ohio	319	321	321	332
Illinois	292	293	294	294
Other states	5,285	5,404	8,588	8,818
Total Revenue Bonds	16,450	16,752	19,586	20,095
Total Obligations of States and Political Subdivisions	$ 98,951	$ 101,255	$ 98,056	$ 100,949

The revenue bonds in the Company's investment securities portfolios were issued by government municipalities and agencies to fund public services such as utilities (water, sewer, and power), educational facilities, and general public and economic improvements. The primary sources of revenue for these bonds are delineated in the table below, which shows the amortized cost and fair market values for the largest revenue concentrations as of the indicated dates.

Revenue Bonds by Type

dollars in thousands, unaudited	September 30, 2015		December 31, 2014	
	Amortized Cost	Fair Market Value	Amortized Cost	Fair Market Value
Revenue bonds				
Revenue source:				
Water	$ 3,653	$ 3,712	$ 7,100	$ 7,278
College & University	3,201	3,300	2,723	2,834
Sales Tax	2,292	2,328	2,361	2,405
Lease	2,198	2,199	1,356	1,362
Electric & Power	1,874	1,884	1,880	1,914
Other sources	3,232	3,329	4,166	4,302
Total Revenue Bonds	$ 16,450	$ 16,752	$ 19,586	$ 20,095

Low-Income Housing Tax Credit ("LIHTC") Fund Investments

The Company has the ability to invest in limited partnerships which own housing projects that qualify for federal and/or California state tax credits, by mandating a specified percentage of low-income tenants for each project. The tax credits flow through to investors, augmenting any returns that might be derived from an increase in property values. Because rent levels are lower than standard market rents and the projects are generally highly leveraged, each project also typically generates tax-deductible operating losses that are allocated to the limited partners.

The Company invested in seven such LIHTC fund limited partnerships from 2001 through 2007, and may make similar investments in the future. Our investments to date have all been in California-focused funds, which helps the Company meet its obligations under the Community Reinvestment Act. We utilize the equity method of accounting for our LIHTC fund investments. Under the equity method, our balance sheet initially reflects an asset that represents the total cash expected to be invested over the life of the partnership. Any commitments or contingent commitments for future investment are reflected as a liability. The income statement treatment under the equity method reflects tax credits received by the Company "below the line" within the income tax provision, while any fund operating results are included "above the line" in non-interest income. As noted above, operating results are typically losses that are netted against non-interest income.

As of September 30, 2015 our total remaining LIHTC investment balance was $5.1 million, and we had no commitments or contingent commitments for additional capital contributions to the limited partnerships. There were $578,000 in tax credits derived from our LIHTC investments which were recognized during the nine months ended September 30, 2015, and a pass-through operating loss of $844,000 associated with those investments was included in pre-tax income for the same time period. Our LIHTC investments are evaluated annually for potential impairment, and we have concluded that the carrying value of the investments is fairly stated and is not impaired.

Note 11 – Credit Quality and Nonperforming Assets

Credit Quality Classifications

The Company monitors the credit quality of loans on a continuous basis using the regulatory and accounting classifications of pass, special mention, substandard and impaired to characterize the associated credit risk. Balances classified as “loss” are immediately charged off. The Company conforms to the following definitions for risk classifications utilized:

- Pass: Larger non-homogeneous loans not meeting the risk rating definitions below, and smaller homogeneous loans that are not assessed on an individual basis.

- Special mention: Loans which have potential issues that deserve the close attention of Management. If left uncorrected, those potential weaknesses could eventually diminish the prospects for full repayment of principal and interest according to the contractual terms of the loan agreement, or could result in deterioration of the Company's credit position at some future date.

- Substandard: Loans that have at least one clear and well-defined weakness that could jeopardize the ultimate recoverability of all principal and interest, such as a borrower displaying a highly leveraged position, unfavorable financial operating results and/or trends, uncertain repayment sources or a deteriorated financial condition.

- Impaired: A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Impaired loans include all nonperforming loans, restructured troubled debt ("TDRs"), and certain other loans that are still being maintained on accrual status. A TDR may be nonperforming or performing, depending on its accrual status and the demonstrated ability of the borrower to comply with restructured terms (see "Troubled Debt Restructurings" section below for additional information on TDRs).

Credit quality classifications for the Company's loan balances were as follows, as of the dates indicated:

Credit Quality Classifications
(dollars in thousands, unaudited)

	September 30, 2015				
	Pass	Special Mention	Substandard	Impaired	Total
Real Estate:					
1-4 family residential construction	$8,146	$374	$ -	$-	$8,520
Other construction/land	31,396	185	-	1,044	32,625
1-4 family - closed end	126,900	686	403	6,487	134,476
Equity lines	40,952	281	1,563	2,034	44,830
Multi-family residential	26,299	-	626	416	27,341
Commercial real estate - owner occupied	191,431	14,265	7,777	3,284	216,757
Commercial real estate - non-owner occupied	141,936	6,795	172	11,941	160,844
Farmland	121,292	4,206	730	47	126,275
Total real estate	688,352	26,792	11,271	25,253	751,668
Agricultural	36,377	373	70	-	36,820
Commercial and industrial	102,635	1,042	571	2,695	106,943
Mortgage Warehouse	142,608	-	-	-	142,608
Consumer loans	13,544	268	17	2,268	16,097
Total gross loans and leases	$983,516	$28,475	$ 11,929	$30,216	$1,054,136

	December 31, 2014				
	Pass	Special Mention	Substandard	Impaired	Total
Real Estate:					
1-4 family residential construction	$5,858	$-	$ -	$-	$5,858
Other construction/land	15,238	247	-	4,423	19,908
1-4 family - closed end	105,398	833	918	7,110	114,259
Equity lines	46,819	294	1,237	1,367	49,717
Multi-family residential	18,127	420	-	171	18,718
Commercial real estate - owner occupied	191,495	18,694	3,845	4,620	218,654
Commercial real estate - non-owner occupied	114,317	4,250	631	12,879	132,077
Farmland	142,295	1,950	744	50	145,039
Total real estate	639,547	26,688	7,375	30,620	704,230
Agricultural	27,215	531	-	-	27,746
Commercial and industrial	108,469	1,529	857	2,916	113,771
Mortgage Warehouse	106,021	-	-	-	106,021
Consumer loans	15,752	222	23	2,888	18,885
Total gross loans and leases	$897,004	$28,970	$ 8,255	$36,424	$970,653

21

Past Due and Nonperforming Assets

Nonperforming assets are comprised of loans for which the Company is no longer accruing interest, and foreclosed assets, including mobile homes and OREO. OREO consists of properties acquired by foreclosure or similar means, which the Company is offering or will offer for sale. Nonperforming loans and leases result when reasonable doubt surfaces with regard to the ability of the Company to collect all principal and interest. At that point, we stop accruing interest on the loan or lease in question and reverse any previously-recognized interest to the extent that it is uncollected or associated with interest-reserve loans. Any asset for which principal or interest has been in default for 90 days or more is also placed on non-accrual status even if interest is still being received, unless the asset is both well secured and in the process of collection. An aging of the Company's loan balances is presented in the following tables, by number of days past due as of the indicated dates:

Loan Portfolio Aging
(dollars in thousands, unaudited)

	September 30, 2015						
	30-59 Days Past Due	60-89 Days Past Due	90 Days Or More Past Due[1]	Total Past Due	Current	Total Financing Receivables	Non-Accrual Loans[2]
Real Estate:							
1-4 family residential construction	$374	$ -	$ -	$ 374	$8,146	$8,520	$ -
Other construction/land	270	-	-	270	32,355	32,625	163
1-4 family - closed end	33	-	461	494	133,982	134,476	2,478
Equity lines	281	47	161	489	44,341	44,830	1,265
Multi-family residential	-	-	-	-	27,341	27,341	-
Commercial real estate - owner occupied	626	-	408	1,034	215,723	216,757	2,547
Commercial real estate - non-owner occupied	-	-	6,689	6,689	154,155	160,844	6,957
Farmland	47	-	-	47	126,228	126,275	47
Total real estate	1,631	47	7,719	9,397	742,271	751,668	13,457
Agricultural	373	70	-	443	36,377	36,820	-
Commercial and industrial	113	134	214	461	106,482	106,943	829
Mortgage warehouse lines	-	-	-	-	142,608	142,608	-
Consumer	228	-	1	229	15,868	16,097	590
Total gross loans and leases	$2,345	$ 251	$ 7,934	$ 10,530	$ 1,043,606	$1,054,136	$14,876

(1) As of September 30, 2015 there were no loans over 90 days past due and still acrruing.

(2) Included in total financing receivables

	December 31, 2014						
	30-59 Days Past Due	60-89 Days Past Due	90 Days Or More Past Due[1]	Total Past Due	Current	Total Financing Receivables	Non-Accrual Loans[2]
Real Estate:							
1-4 family residential construction	$-	$ 332	$ -	$ 332	$5,526	$ 5,858	$ -
Other construction/land	93	59	3,253	3,405	16,503	19,908	3,547
1-4 family - closed end	1,125	597	2,874	4,596	109,663	114,259	3,042
Equity lines	98	44	214	356	49,361	49,717	1,049
Multi-family residential	185	-	171	356	18,362	18,718	171
Commercial real estate - owner occupied	1,460	26	1,316	2,802	215,852	218,654	3,417
Commercial real estate - non-owner occupied	604	294	6,953	7,851	124,226	132,077	7,754
Farmland	997	-	-	997	144,042	145,039	51
Total real estate	4,562	1,352	14,781	20,695	683,535	704,230	19,031
Agricultural	618	-	-	618	27,128	27,746	-
Commercial and industrial	1,346	153	39	1,538	112,233	113,771	821
Mortgage warehouse lines	-	-	-	-	106,021	106,021	-
Consumer	136	17	-	153	18,732	18,885	826
Total gross loans and leases	$6,662	$ 1,522	$ 14,820	$ 23,004	$947,649	$ 970,653	$ 20,678

[1] As of December 31, 2014 there were no loans over 90 days past due and still accruing.

[2] Included in total financing receivables

Troubled Debt Restructurings

A loan that is modified for a borrower who is experiencing financial difficulty is classified as a troubled debt restructuring if the modification constitutes a concession. At September 30, 2015, the Company had a total of $23.2 million in TDRs, including $11.3 million in TDRs that were on non-accrual status. Generally, a non-accrual loan that has been modified as a TDR remains on non-accrual status for a period of at least six months to demonstrate the borrower's ability to comply with the modified terms. However, performance prior to the modification, or significant events that coincide with the modification, could result in a loan's return to accrual status after a shorter performance period or even at the time of loan modification. TDRs may have the TDR designation removed in the calendar year following the restructuring, if the loan is in compliance with all modified terms and is yielding a market rate of interest. Regardless of the period of time that has elapsed, if the borrower's ability to meet the revised payment schedule is uncertain then the loan will be kept on non-accrual status. Moreover, a TDR is generally considered to be in default when it appears that the customer will not likely be able to repay all principal and interest pursuant to restructured terms.

The Company may agree to different types of concessions when modifying a loan or lease. The tables below summarize TDRs which were modified during the noted periods, by type of concession:

Troubled Debt Restructurings, by Type of Loan Modification

(dollars in thousands, unaudited)	Three months ended September 30, 2015				
	Rate Modification	Term Modification	Rate & Term Modification	Term & Interest Only Modification	Total
Real estate:					
Other construction/land	$ -	$ -	$ -	$ -	$ -
1-4 family - closed-end	-	-	4,388	-	4,388
Equity lines	-	256	-	-	256
Multi-family residential	-	-	-	-	-
Commercial real estate - owner occupied	-	-	-	-	-
Total real estate loans	-	256	4,388	-	4,644
Commercial and industrial	-	45	-	-	45
Consumer loans	-	10	-	-	10
	$ -	$ 311	$ 4,388	$ -	$ 4,699

	Three months ended September 30, 2014				
	Rate Modification	Term Modification	Rate & Term Modification	Term & Interest Only Modification	Total

Real Estate:					
Other construction/land	$ -	$ -	$ -	$ -	$ -
1-4 family - closed-end	-	-	-	-	-
Equity lines	-	227	-	-	227
Multi-family residential	-	-	-	-	-
Commercial real estate - owner occupied	-	-	-	-	-
Total real estate loans	-	227	-	-	227
Commercial and industrial	-	-	-	-	-
Consumer loans	-	-	103	-	103
	$ -	$ 227	$ 103	$ -	$ 330

23

Troubled Debt Restructurings, by Type of Loan Modification

(dollars in thousands, unaudited)	Nine months ended September 30, 2015				
	Rate Modification	Term Modification	Rate & Term Modification	Term & Interest Only Modification	Total
Real estate:					
Other construction/land	$ -	$ 111	$ -	$ -	$ 111
1-4 family - closed-end	-	-	4,614	-	4,614
Equity lines	-	607	290	-	897
Multi-family residential	-	418	-	-	418
Commercial real estate - owner occupied	-	-	-	-	-
Total real estate loans	-	1,136	4,904	-	6,040
Commercial and industrial	-	113	-	-	113
Consumer loans	-	10	-	-	10
	$ -	$ 1,259	$ 4,904	$ -	$ 6,163

	Nine months ended September 30, 2014				
	Rate Modification	Term Modification	Rate & Term Modification	Term & Interest Only Modification	Total
Real Estate:					
Other construction/land	$ -	$ -	$ -	$ -	$ -
1-4 family - closed-end	-	13	-	-	13
Equity lines	-	548	29	-	577
Multi-family residential	-	-	-	-	-
Commercial real estate - owner occupied	279	123	-	-	402
Total real estate loans	279	684	29	-	992
Commercial and industrial	-	133	4	30	167
Consumer loans	-	9	103	-	112
	$ 279	$ 826	$ 136	$ 30	$ 1,271

The following tables present, by class, additional details related to loans classified as TDRs during the referenced periods, including the recorded investment in the loan both before and after modification and balances that were modified during the period:

Troubled Debt Restructurings

(dollars in thousands, unaudited)

	Three months ended September 30, 2015				
	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Reserve Difference[1]	Reserve
Real Estate:					
Other Construction/Land	0	$ -	$ -	$ -	$ -
1-4 family - closed-end	9	4,388	4,388	148	85
Equity Lines	2	256	256	10	74
Multi-family residential	0	-	-	-	-
Commercial RE- owner occupied	0	-	-	-	-
Total Real Estate Loans		4,644	4,644	158	159
Commercial and Industrial	1	45	45	2	2
Consumer loans	1	10	10	1	-
		$ 4,699	$ 4,699	$ 161	$ 161

[1] This represents the change in the ALLL reserve for these credits measured as the difference between the specific post-modification impairment reserve and the pre-modification reserve calculated under our general allowance for loan loss methodology.

	Three months ended September 30, 2014				
	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Reserve Difference[1]	Reserve
Real Estate:					
Other Construction/Land	0	$ -	$ -	$ -	$ -
1-4 family - closed-end	0	-	-	-	-
Equity Lines	3	227	227	11	20
Multi-family residential	0	-	-	-	-
Commercial RE- owner occupied	0	-	-	-	-

Total Real Estate Loans		227	227	11	20
Commercial and Industrial	0	-	-	-	-
Consumer loans	1	103	103	14	15
		$ 330	$ 330	$ 25	$ 35

[1] This represents the change in the ALLL reserve for these credits measured as the difference between the specific post-modification impairment reserve and the pre-modification reserve calculated under our general allowance for loan loss methodology.

	Nine months ended September 30, 2015				
	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Reserve Difference[1]	Reserve
Real Estate:					
Other Construction/Land	2	$ 111	$ 111	$ 4	$ 1
1-4 family - closed-end	11	4,614	4,614	154	86
Equity Lines	9	897	897	152	296
Multi-family residential	1	418	418	-	1
Commercial RE- owner occupied	0	-	-	-	-
Total Real Estate Loans		6,040	6,040	310	384
Commercial and Industrial	4	113	113	(17)	23
Consumer loans	1	10	10	1	-
		$ 6,163	$ 6,163	$ 294	$ 407

[1] This represents the change in the ALLL reserve for these credits measured as the difference between the specific post-modification impairment reserve and the pre-modification reserve calculated under our general allowance for loan loss methodology.

	Nine months ended September 30, 2014				
	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Reserve Difference[1]	Reserve
Real Estate:					
Other Construction/Land	0	$ -	$ -	$ -	$ -
1-4 family - closed-end	1	13	13	-	-
Equity Lines	6	577	577	180	33
Multi-family residential	0	-	-	-	-
Commercial RE- owner occupied	2	402	402	-	136
Total Real Estate Loans		992	992	180	169
Commercial and Industrial	5	167	167	53	57
Consumer loans	4	112	112	15	15
		$ 1,271	$ 1,271	$ 248	$ 241

[1] This represents the change in the ALLL reserve for these credits measured as the difference between the specific post-modification impairment reserve and the pre-modification reserve calculated under our general allowance for loan loss methodology.

The table below summarizes finance receivables modified as TDRs within the previous twelve months that defaulted during the periods noted, and any charge-offs on those TDRs resulting from such default.

Troubled Debt Restructurings

(dollars in thousands, unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2015	2014	2015	2014
Commercial and Industrial				
Number of loans	-	-	-	1
Recorded investment	$ -	$ -	$ -	$ 127
Charge-offs	$ -	$ -	$ -	$ -

Purchased Credit Impaired Loans

The Company may acquire loans which show evidence of credit deterioration since origination. These purchased credit impaired ("PCI") loans are recorded at the amount paid, since there is no carryover of the seller's allowance for loan losses. Potential losses on PCI loans subsequent to acquisition are recognized by an increase in the allowance for loan losses. PCI loans are accounted for individually or are aggregated into pools of loans based on common risk characteristics. The Company estimates the amount and timing of expected cash flows, and expected cash receipts in excess of the amount paid for the loan(s) are recorded as interest income over the remaining life of the loan or pool of loans (accretable yield). The excess of contractual principal and interest over expected cash flows is not recorded (nonaccretable difference). Expected cash flows are periodically re-evaluated throughout the life of the loan or pool of loans. If the present value of the expected cash flows is determined at any time to be less than the carrying amount, a reserve is recorded. If the present value of the expected cash flows is greater than the carrying amount, it is recognized as part of future interest income.

The acquisition described in Note 13, Recent Developments, included a portfolio of loans, some of which have shown evidence of credit deterioration since origination and for which it was probable at acquisition that all contractually required payments would not be collected. The carrying amount and unpaid principal balance of those PCI loans was as follows, as of the dates indicated (dollars in thousands):

Purchased Credit Impaired Loans:

	September 30, 2015	
	Unpaid Principal Balance	Carrying Value
Real estate secured	$ 1,177	$ 242
Commercial and industrial	44	-
Consumer	1	-
Total purchased credit impaired loans	$ 1,222	$ 242

	December 31, 2014	
	Unpaid Principal Balance	Carrying Value
Real estate secured	$ 1,222	$ 228
Commercial and industrial	92	-
Consumer	1	-
Total purchased credit impaired loans	$ 1,315	$ 228

An $89,000 allowance for loan losses was allocated for PCI loans as of September 30, 2015, but there was no allowance for those loans at December 31, 2014. We also recorded $216,000 in discount accretion on PCI loans during the nine months ended September 30, 2015.

<u>Note 12 – Allowance for Loan and Lease Losses</u>

The Company’s allowance for loan and lease losses, a contra-asset, is established through a provision for loan and lease losses. The allowance is maintained at a level that is considered adequate to absorb probable losses on certain specifically identified 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 cash payments are received subsequent to the charge off. We employ a systematic methodology, consistent with FASB guidelines on loss contingencies and impaired loans, for determining the appropriate level of the allowance for loan and lease losses and adjusting it at least quarterly. Pursuant to that methodology, impaired loans and leases are individually analyzed and a criticized asset action plan is completed specifying the financial status of the borrower and, if applicable, the characteristics and condition of collateral and any associated liquidation plan. A specific loss allowance is created for each impaired loan, if necessary.

The following tables disclose the unpaid principal balance, recorded investment, average recorded investment, and interest income recognized for impaired loans on our books as of the dates indicated. Balances are shown by loan type, and are further broken out by those that required an allowance and those that did not, with the associated allowance disclosed for those that required such. Included in the valuation allowance for impaired loans shown in the tables below are specific reserves allocated to TDRs, totaling $2.421 million at September 30, 2015 and $2.714 million at December 31, 2014.

Impaired Loans	September 30, 2015				
(dollars in thousands, unaudited)	Unpaid Principal Balance[1]	Recorded Investment[2]	Related Allowance	Average Recorded Investment	Interest Income Recognized[3]
With an allowance recorded					
Real Estate:					
Other construction/land	$639	$ 603	$ 82	$ 589	$ 34
1-4 Family - closed-end	7,935	5,987	246	4,358	189
Equity lines	1,733	1,680	509	1,578	12
Multi-family residential	416	416	1	372	4
Commercial real estate- owner occupied	1,607	1,607	743	1,571	33
Commercial real estate- non-owner occupied	10,060	10,060	2,039	9,519	124
Farmland	-	-	-	-	-
Total real estate	22,390	20,353	3,620	17,987	396
Commercial and industrial	2,612	2,600	753	2,486	68
Consumer loans	2,239	2,238	356	2,227	95
	27,241	25,191	4,729	22,700	559
With no related allowance recorded					
Real estate:					
Other construction/land	554	441	-	509	24
1-4 family - closed-end	723	500	-	659	-
Equity lines	372	354	-	337	-
Multi-family residential	-	-	-	-	-
Commercial real estate- owner occupied	1,677	1,677	-	1,592	-
Commercial real estate- non-owner occupied	2,029	1,881	-	1,881	89
Farmland	47	47	-	46	-
Total real estate	5,402	4,900	-	5,024	113
Commercial and industrial	112	95	-	138	-
Consumer loans	202	30	-	249	-
	5,716	5,025	-	5,411	113
Total	$32,957	$ 30,216	$ 4,729	$ 28,111	$ 672

[1]Contractual principal balance due from customer.

[2]Principal balance on Company's books, less any direct charge offs.

[3]Interest income is recognized on performing balances on a regular accrual basis.

29

	December 31, 2014				
	Unpaid Principal Balance[1]	Recorded Investment[2]	Related Allowance	Average Recorded Investment	Interest Income Recognized[3]
With an allowance recorded					
Real estate:					
Other construction/land	$1,155	$ 1,078	$ 179	$ 1,193	$ 70
1-4 family - closed-end	4,167	4,167	288	4,276	258
Equity lines	797	797	230	878	14
Multifamily residential	171	171	51	173	-
Commercial real estate- owner occupied	2,791	2,681	1,385	3,069	60
Commercial real estate- non-owner occupied	3,463	3,463	1,731	3,545	263
Farmland	-	-	-	-	-
Total real estate	12,544	12,357	3,864	13,134	665
Commercial and industrial	2,910	2,898	916	3,046	123
Consumer loans	2,790	2,788	668	3,115	150
	18,244	18,043	5,448	19,295	938
With no related allowance recorded					
Real estate:					
Other construction/land	3,345	3,345	-	4,143	-
1-4 family - closed-end	2,943	2,943	-	9,186	-
Equity lines	609	570	-	611	-
Multifamily residential	-	-	-	-	-
Commercial real estate- owner occupied	2,915	1,939	-	3,046	-
Commercial real estate- non-owner occupied	9,563	9,416	-	10,306	118
Farmland	51	50	-	52	-
Total real estate	19,426	18,263	-	27,344	118
Commercial and industrial	35	18	-	81	-
Consumer loans	275	100	-	347	-
	19,736	18,381	-	27,772	118
Total	$37,980	$ 36,424	$ 5,448	$ 47,067	$ 1,056

[1]Contractual principal balance due from customer.

[2]Principal balance on Company's books, less any direct charge offs.

[3]Interest income is recognized on performing balances on a regular accrual basis.

The specific loss allowance for an impaired loan generally represents the difference between the book value of the loan and either the fair value of underlying collateral less estimated disposition costs, or the loan’s net present value as determined by a discounted cash flow analysis. The discounted cash flow approach is typically used to measure impairment on loans for which it is anticipated that repayment will be provided from cash flows other than those generated solely by the disposition or operation of underlying collateral. However, historical loss rates may be used to determine a specific loss allowance if they indicate a higher potential reserve need than the discounted cash flow

analysis. Any change in impairment attributable to the passage of time is accommodated by adjusting the loss allowance accordingly.

For loans where repayment is expected to be provided by the disposition or operation of the underlying collateral, impairment is measured using the fair value of the collateral. If the collateral value, net of the expected costs of disposition where applicable, is less than the loan balance, then a specific loss reserve is established for the shortfall in collateral coverage. If the discounted collateral value is greater than or equal to the loan balance, no specific loss reserve is required. At the time a collateral-dependent loan is designated as nonperforming, a new appraisal is ordered and typically received within 30 to 60 days if a recent appraisal is not already available. We generally use external appraisals to determine the fair value of the underlying collateral for nonperforming real estate loans, although the Company's licensed staff appraisers may update older appraisals based on current market conditions and property value trends. Until an updated appraisal is received, the Company uses the existing appraisal to determine the amount of the specific loss allowance that may be required. The specific loss allowance is adjusted, as necessary, once a new appraisal is received. Updated appraisals are generally ordered at least annually for collateral-dependent loans that remain impaired. Current appraisals were available for 97% of the Company's impaired real estate loan balances at September 30, 2015. Furthermore, the Company analyzes collateral-dependent loans on at least a quarterly basis, to determine if any portion of the recorded investment in such loans can be identified as uncollectible and would therefore constitute a confirmed loss. All amounts deemed to be uncollectible are promptly charged off against the Company's allowance for loan and lease losses, with the loan then carried at the fair value of the collateral, as appraised, less estimated costs of disposition if applicable. Once a charge-off or write-down is recorded, it will not be restored to the loan balance on the Company's accounting books.

Our methodology also provides that a "general" allowance be established for probable incurred losses inherent in loans and leases that are not impaired. Unimpaired loan balances are segregated by credit quality, and are then evaluated in pools with common characteristics. At the present time, pools are based on the same segmentation of loan types presented in our regulatory filings. While this methodology utilizes historical loss data and other measurable information, the classification of loans and the establishment of the allowance for loan and lease losses are both to some extent based on Management's judgment and experience. Our methodology incorporates a variety of risk considerations, both quantitative and qualitative, in establishing an allowance for loan and lease losses that Management believes is appropriate at each reporting date. Quantitative information includes our historical loss experience, delinquency and charge-off trends, and current collateral values. Qualitative factors include the general economic environment in our markets and, in particular, the condition of the agricultural industry and other key industries. Lending policies and procedures (including underwriting standards), the experience and abilities of lending staff, the quality of loan review, credit concentrations (by geography, loan type, industry and collateral type), the rate of loan portfolio growth, and changes in legal or regulatory requirements are additional factors that are considered. The total general reserve established for probable incurred losses on unimpaired loans was $5.683 million at September 30, 2015.

There were no material changes to the methodology used to determine our allowance for loan and lease losses during the three months ended September 30, 2015. We continue to consider the potential impact of drought conditions and lower oil prices on loan losses, in qualitative factors. As we add new products and expand our geographic coverage, and as the economic environment changes, we expect to enhance our methodology to keep pace with the size and complexity of the loan and lease portfolio and respond to pressures created by external forces. We engage outside firms on a regular basis to assess our methodology and perform independent credit reviews of our loan and lease portfolio. In addition, the Company's external auditors, the FDIC, and the California DBO review the allowance for loan and lease losses as an integral part of their audit and examination processes. Management believes that the current methodology is appropriate given our size and level of complexity.

The tables that follow detail the activity in the allowance for loan and lease losses for the periods noted:

<u>Allowance for Credit Losses and Recorded Investment in Financing Receivables</u>

(dollars in thousands, unaudited)

	Three months ended September 30, 2015					
	Real Estate	Agricultural Products	Commercial and Industrial	Consumer	Unallocated	Total
Allowance for credit losses:						
Beginning Balance	$5,602	$ 625	$ 2,592	$ 1,404	$ 326	$10,549
Charge-offs	-	-	(80)	(522)	-	(602)
Recoveries	65	73	65	262	-	465
Provision	14	(25)	(353)	212	152	-
Ending Balance	$5,681	$ 673	$ 2,224	$ 1,356	$ 478	$10,412

	Nine months ended September 30, 2015					
	Real Estate	Agricultural Products	Commercial and Industrial	Consumer	Unallocated	Total
Allowance for credit losses:						
Beginning Balance	$6,243	$ 986	$ 1,944	$ 1,765	$ 310	$11,248
Charge-offs	(686)	-	(255)	(1,313)	-	(2,254)
Recoveries	441	78	189	710	-	1,418
Provision	(317)	(391)	346	194	168	-
Ending Balance	$5,681	$ 673	$ 2,224	$ 1,356	$ 478	$10,412
Reserves:						
Specific	$3,620	$ -	$ 753	$ 356	$ -	$4,729
General	2,061	673	1,471	1,000	478	5,683
Ending Balance	$5,681	$ 673	$ 2,224	$ 1,356	$ 478	$10,412
Loans evaluated for impairment:						
Individually	$25,253	$ -	$ 2,695	$ 2,268	$ -	$30,216
Collectively	726,415	36,820	246,856	13,829	-	1,023,920
Ending Balance	$751,668	$ 36,820	$ 249,551	$ 16,097	$ -	$1,054,136

	Year ended December 31, 2014					
	Real Estate	Agricultural Products	Commercial and Industrial	Consumer	Unallocated	Total
Allowance for credit losses:						
Beginning Balance	$5,544	$ 978	$ 3,787	$ 1,117	$ 251	$11,677
Charge-offs	(1,629)	(124)	(625)	(1,837)	-	(4,215)
Recoveries	1,913	6	801	716	-	3,436
Provision	415	126	(2,019)	1,769	59	350
Ending Balance	$6,243	$ 986	$ 1,944	$ 1,765	$ 310	$11,248
Reserves:						
Specific	$3,864	$ -	$ 916	$ 668	$ -	$5,448
General	2,379	986	1,028	1,097	310	5,800
Ending Balance	$6,243	$ 986	$ 1,944	$ 1,765	$ 310	$11,248
Loans evaluated for impairment:						
Individually	$30,620	$ -	$ 2,916	$ 2,888	$ -	$36,424
Collectively	673,610	27,746	216,876	15,997	-	934,229
Ending Balance	$704,230	$ 27,746	$ 219,792	$ 18,885	$ -	$970,653

Note 13 – Recent Developments

In July 2014 the Bank entered into a definitive agreement to acquire Santa Clara Valley Bank, a community bank with branches in Santa Paula, Santa Clarita, and Fillmore, California. Subsequent to the receipt of requisite regulatory and shareholder approvals the deal closed on November 14, 2014, and SCVB results of operations were included in the Company's results beginning on the same date. As part of the transaction, cash consideration of $12.3 million, or $6.00 per share, was paid to SCVB common shareholders, and $3.0 million was paid to SCVB preferred shareholders to retire outstanding preferred stock and associated warrants. One-time acquisition costs of $2.1 million were included in the Company's pre-tax non-interest expense in 2014, and residual acquisition costs totaling $101,000 have been reflected in pre-tax non-interest expense in 2015.

As of the merger date the SCVB acquisition contributed approximately $62 million to the Company's outstanding loan balances, $44 million to investment securities, and $108 million to total deposits. In accordance with GAAP, assets and liabilities were acquired at their estimated fair values and there was no carryover of the allowance for loan losses that had previously been recorded by SCVB. At the time of the acquisition the Company also recorded a deferred income tax asset of $2.3 million related primarily to SCVB's net operating loss carry-forward, along with the effects of fair value adjustments resulting from applying the acquisition method of accounting. In accordance with GAAP, the Company recorded $1.4 million of goodwill and $1.1 in core deposit intangibles. Goodwill represents the excess of consideration transferred (cash) over the fair values of the identifiable net assets acquired. The core deposit intangible is being amortized on a straight line basis over eight years, commencing at the date of acquisition. Goodwill and core deposit intangibles are not deductible for income tax purposes.

The following table presents unaudited pro forma information as if the acquisition had occurred at the beginning of 2014. The unaudited pro forma information includes adjustments for interest income on loans and securities acquired, amortization of intangibles arising from the transaction, depreciation expense on property acquired, interest expense on deposits acquired, and the related income tax effects. The unaudited pro forma financial information is not necessarily indicative of the results of operations that would have occurred had the transactions been effected on the assumed dates (dollars in thousands):

Business Combinations - Pro forma Income Statement

	Pro forma for the quarter ended September 30, 2014	Pro forma for the nine months ended September 30, 2014
Net interest income	$ 14,285	$ 41,551
Net Income	$ 3,534	$ 11,449

Earnings per share basic	$	0.25	$	0.81
Earnings per share diluted	$	0.25	$	0.81

PART I - FINANCIAL INFORMATION

ITEM 2

MANAGEMENT'S DISCUSSION AND

ANALYSIS OF FINANCIAL CONDITION

AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS

This Form 10-Q includes forward-looking statements that involve inherent risks and uncertainties. Words such as "expects", "anticipates", "believes", "projects", and "estimates" or variations of such words and similar expressions are intende to identify forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed, forecast in, or implied by such forward-looking statements.

A variety of factors could have a material adverse impact on the Company's financial condition or results of operations, and should be considered when evaluating the Company's potential future financial performance. They include, but are not limited to, the potential impact of extreme drought conditions on businesses and consumers located in the Company's market areas; unfavorable economic conditions in the Company's service areas; risks associated with fluctuations in interest rates; liquidity risks; increases in nonperforming assets and credit losses that could occur, particularly in times of weak economic conditions or rising interest rates; reductions in the market value of available-for-sale securities that could result if interest rates increase substantially or an issuer has real or perceived financial difficulties; the Company's ability to attract and retain skilled employees; the Company's ability to successfully deploy new technology; the success of acquisitions or branch expansion; and risks associated with the multitude of current and prospective laws and regulations to which the Company is and will be subject. Additional risk factors that could cause actual results to differ materially from results that might be implied by forward-looking statements include the risk factors disclosed in the Company's Form 10-K for the fiscal year ended December 31, 2014.

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 the allowance for loan and lease losses, as explained in detail in Note 12 to the consolidated financial statements and in the "Provision for Loan and Lease 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 11 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 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

Third Quarter 2015 compared to Third Quarter 2014

Net income for the quarter ended September 30, 2015 was $4.410 million, representing an increase of $859,000, or 24%, relative to net income of $3.551 million for the quarter ended September 30, 2014. Basic and diluted earnings per share for the third quarter of 2015 were both $0.33, compared to $0.25 basic and diluted earnings per share for the third quarter of 2014. The Company's annualized return on average equity was 9.32% and annualized return on average assets was 1.03% for the quarter ended September 30, 2015, compared to 7.51% and 0.95%, respectively, for the quarter ended September 30, 2014. The primary drivers behind the quarter over quarter variance in net income are as follows:

- Net interest income was up $1.585 million, or 12%, for the comparative quarters, due to an increase of $203 million, or 15%, in average interest-earning assets that was partially offset by the impact of an eleven basis point drop in our net interest margin.

- Total non-interest income rose by $476,000, or 13%, for the quarterly comparison, due in large part to fees earned from increased activity on deposit accounts and gains on investments, partially offset by a drop in income on bank-owned life insurance ("BOLI") and higher pass-through costs on low-income housing tax credit investments.

- Total non-interest expense increased $535,000, or 5%, due in large part to ongoing operating costs related to our acquisition of Santa Clara Valley Bank, other increases in personnel costs, an increase in telecommunications expense, and higher debit card losses, partially offset by reductions in loan costs, non-recurring acquisition costs, and deferred compensation expense (related to the drop in bank-owned life insurance income).

- The Company's provision for income taxes was 36% of pre-tax income in the third quarter of 2015 relative to 33% in the third quarter of 2014. The higher tax provisioning in 2015 is primarily the result of higher taxable income and a declining level of available tax credits.

First Nine Months of 2015 compared to First Nine Months of 2014

Net income for the first nine months of 2015 was $12.704 million, representing an increase of $1.118 million, or 10%, relative to net income of $11.586 million for the first nine months of 2014. Basic and diluted earnings per share for the first nine months of 2015 were $0.94 and $0.93, respectively, compared to $0.82 basic earnings per share and $0.81 diluted earnings per share for the first nine months of 2014. The Company's annualized return on average equity was 9.02% and annualized return on average assets was 1.01% for the nine months ended September 30, 2015, compared to a return on equity of 8.33% and return on assets of 1.06% for the nine months ended September 30, 2014. The primary drivers behind the variance in year-to-date net income are as follows:

- Net interest income increased $6.158 million, or 16%, due to a $216 million increase in average interest-earning assets that was partially offset by a three basis point decline in our net interest margin.

- Total non-interest income was up $1.412 million, or 12%, in the first nine months of 2015 due primarily to fees earned from increased activity on customer deposit accounts, investment gains, and a special dividend on our FHLB stock in the second quarter of 2015, partially offset by a drop in BOLI income.

- There was no loan loss provision for the first nine months of 2015, relative to a $350,000 provision in the first nine months of 2014.

- Total non-interest expense increased by $5.010 million, or 15%, with the year-to-date increase impacted by the same factors as the third quarter comparison, as well as higher core processing costs subsequent to our core system conversion in mid-February 2014, and a $507,000 unfavorable swing in expenses associated with foreclosed assets due to substantial gains from the sale of OREO in the first quarter of 2014.

- The Company's provision for income taxes was 33% of pre-tax income for the first nine months of 2015, relative to 28% for the first nine months of 2014.

Financial Condition Summary

September 30, 2015 relative to December 31, 2014

The Company's assets totaled $1.717 billion at September 30, 2015, relative to total assets of $1.637 billion at December 31, 2014. Total liabilities were $1.530 billion at September 30, 2015 compared to $1.450 billion at the end of 2014, and shareholders' equity totaled $187 million at both September 30, 2015 and December 31, 2014. The following is a summary of key balance sheet changes during the first nine months of 2015:

- The Company's assets increased $80 million, or 5%, due to growth in loans that was partially offset by slightly lower cash balances and investments.

- While declining during the third quarter due to lower utilization on mortgage warehouse lines, gross loans increased by $83 million, or 9%, for the first nine months of 2015 and ended the period at $1.054 billion as a result of strong year-to-date growth in mortgage warehouse loans, the first quarter purchase of $28 million in residential mortgage loans, and organic growth in other non-farm real estate loans and agricultural production loans.

- Total nonperforming assets were reduced by $7 million, or 28%, during the first nine months of 2015. The Company's ratio of nonperforming assets to total loans plus foreclosed assets was 1.69% at September 30, 2015, compared to 2.53% at December 31, 2014.

- The Company's deposit balances peaked at the end of June and are down $43 million since then, but they still reflect net growth of $62 million, or 5%, during the nine months ended September 30, 2015 due primarily to an increase of $61 million, or 6%, in core non-maturity deposits. The drop in deposits in the third quarter is due to a combination of factors, including seasonality and our customers' reallocation of resources to other investments and tax payments, among other things. Deposits totaled $1.429 billion at September 30, 2015.

- We increased non-deposit interest-bearing liabilities by $22 million, or 36%, during the first nine months of 2015 to support our strong loan growth.

- Total capital of $187 million at September 30, 2015 was unchanged relative to the beginning of the year, since the Company's repurchase of shares, the payment of cash dividends, and a drop in accumulated other comprehensive income offset the addition of net income to retained earnings and the impact of stock options exercised during the first nine months of 2015. While still robust, our consolidated total risk-based capital ratio declined to 17.71% at September 30, 2015 from 18.44% at year-end 2014, due to higher risk-adjusted assets resulting from loan growth.

EARNINGS PERFORMANCE

The Company earns income from two primary sources. The first is net interest income, which is interest income generated by loans and investments less interest expense on deposits and other borrowed money. The second is non-interest income, which primarily consists of customer service charges and fees but also comes from non-customer sources such as bank-owned life insurance. The majority of the Company's non-interest expense is comprised of operating costs that relate to providing a full range of banking services to our customers.

Net interest income AND NET INTEREST MARGIN

Net interest income increased by $1.585 million, or 12%, for the third quarter of 2015 relative to the third quarter of 2014, and by $6.158 million, or 16%, in the first nine months of 2015 compared to the first nine months of 2014. 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 during the reporting period, 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 tables show average balances for significant balance sheet categories and the amount of interest income or interest expense associated with each category for the noted periods. The tables also display the calculated yields on each major component of the Company's investment and loan portfolios, the average rates paid on each key segment of the Company's interest-bearing liabilities, and our net interest margin for the noted periods.

Average Balances and Rates (dollars in thousands, except per share data)	For the three months ended Ended September 30, 2015			For the three months ended Ended September 30, 2014		
	Average Balance [1]	Income/ Expense	Average Rate/Yield [2][3]	Average Balance [1]	Income/ Expense	Average Rate/Yield [2][3]
Assets						
Investments:						
Federal funds sold/due from time	$11,338	$7	0.24 %	$6,149	$4	0.25 %
Taxable	405,815	1,847	1.78 %	364,441	2,008	2.16 %
Non-taxable	100,352	746	4.48 %	97,819	729	4.49 %
Total investments	517,505	2,600	2.27 %	468,409	2,741	2.62 %
Loans and Leases:[4]						
Real estate	739,583	9,608	5.15 %	641,766	8,403	5.19 %
Agricultural	33,305	346	4.12 %	25,926	244	3.73 %
Commercial	106,526	1,212	4.51 %	98,552	1,078	4.34 %
Consumer	16,548	430	10.31 %	20,297	501	9.79 %
Mortgage warehouse lines	138,657	1,271	3.64 %	95,323	966	4.02 %
Direct financing leases	1,813	24	5.25 %	2,266	31	5.43 %
Other	2,008	33	6.52 %	305	14	18.21 %
Total loans and leases	1,038,440	12,924	4.94 %	884,435	11,237	5.04 %
Total interest earning assets [5]	1,555,945	15,524	4.06 %	1,352,844	13,978	4.10 %
Other earning assets	7,546			6,122		
Non-earning assets	138,800			126,454		
Total assets	$1,702,291			$1,485,420		
Liabilities and shareholders' equity						
Interest bearing deposits:						
Demand deposits	$130,932	$97	0.29 %	$109,825	$76	0.27 %
NOW	293,575	86	0.12 %	251,825	84	0.13 %
Savings accounts	191,776	54	0.11 %	153,670	44	0.11 %
Money market	106,373	19	0.07 %	74,014	16	0.09 %
CDAR's	11,605	2	0.07 %	12,817	8	0.25 %
Certificates of deposit<$100,000	75,770	60	0.31 %	75,713	80	0.42 %
Certificates of deposit≥$100,000	219,034	134	0.24 %	199,666	172	0.34 %
Brokered deposits	-	-	0.00 %	6,337	23	1.44 %
Total interest bearing deposits	1,029,065	452	0.17 %	883,867	503	0.23 %
Borrowed Funds:						
Federal funds purchased	17	-	-	1	-	-
Repurchase agreements	10,093	10	0.39 %	5,289	5	0.38 %
Short term borrowings	3,915	2	0.20 %	6,413	1	0.06 %
Long term borrowings	2,000	2	0.40 %	-	-	-
TRUPS	30,928	181	2.32 %	30,928	177	2.27 %
Total borrowed funds	46,953	195	1.65 %	42,631	183	1.70 %
Total interest bearing liabilities	1,076,018	647	0.24 %	926,498	686	0.29 %
Demand deposits - non-interest bearing	423,789			355,994		
Other liabilities	14,788			15,320		
Shareholders' equity	187,696			187,608		

Total liabilities and shareholders' equity	$1,702,291				$1,485,420		
Interest income/interest earning assets			4.06	%		4.21	%
Interest expense/interest earning assets			0.16	%		0.20	%
Net interest income and margin[6]		$14,877	3.90	%	$13,292	4.01	%

(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 utilizing a 35% effective tax rate.

(3) Annualized

(4) Loan costs have been included in the calculation of interest income. Loan costs were approximately $56 thousand and $259 thousand for the quarters ended September 30, 2015 and 2014. Loans are gross of the allowance for possible loan losses.

(5) Non-accrual loans have been included in total loans for purposes of total earning assets.

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

Average Balances and Rates (dollars in thousands, except per share data)	For the nine months ended September 30, 2015			For the nine months ended September 30, 2014		
	Average Balance [1]	Income/ Expense	Average Rate/Yield [2][3]	Average Balance [1]	Income/ Expense	Average Rate/Yield [2][3]
Assets						
Investments:						
Federal funds sold/Due from time	$12,943	$26	0.26 %	$28,239	$55	0.26 %
Taxable	408,609	6,191	2.00 %	354,033	5,709	2.13 %
Non-taxable	99,222	2,202	4.50 %	97,193	2,203	4.60 %
Total Investments	520,774	8,419	2.43 %	479,465	7,967	2.52 %
Loans and Leases:[4]						
Real Estate	715,300	28,048	5.24 %	618,600	24,626	5.32 %
Agricultural	29,850	915	4.10 %	24,798	737	3.97 %
Commercial	107,514	3,751	4.66 %	97,493	3,253	4.46 %
Consumer	17,401	1,273	9.78 %	21,747	1,469	9.03 %
Mortgage Warehouse Lines	142,832	3,965	3.71 %	77,343	2,429	4.20 %
Direct Financing Leases	1,926	76	5.28 %	2,367	96	5.42 %
Other	2,100	96	6.11 %	293	34	15.51 %
Total Loans and Leases	1,016,923	38,124	5.01 %	842,641	32,644	5.18 %
Total Interest Earning Assets [5]	1,537,697	46,543	4.15 %	1,322,106	40,611	4.23 %
Other Earning Assets	7,330			6,043		
Non-Earning Assets	138,318			129,603		
Total Assets	$1,683,345			$1,457,752		
Liabilities and Shareholders' Equity						
Interest Bearing Deposits:						
Demand Deposits	$122,329	$270	0.30 %	$104,481	$209	0.27 %
NOW	290,102	258	0.12 %	239,614	253	0.14 %
Savings Accounts	184,303	154	0.11 %	151,362	195	0.17 %
Money Market	111,916	61	0.07 %	73,035	57	0.10 %
CDAR's	11,392	6	0.07 %	12,999	24	0.25 %
Certificates of Deposit<$100,000	77,639	187	0.32 %	77,797	258	0.44 %
Certificates of Deposit≥$100,000	215,095	398	0.25 %	201,697	546	0.36 %
Brokered Deposits	861	11	1.71 %	6,256	72	1.54 %
Total Interest Bearing Deposits	1,013,637	1,345	0.18 %	867,241	1,614	0.25 %
Borrowed Funds:						
Federal Funds Purchased	8	-	-	15	-	-
Repurchase Agreements	8,498	25	0.39 %	5,753	14	0.33 %
Short Term Borrowings	13,259	18	0.18 %	2,408	2	0.11 %
Long Term Borrowings	2,674	9	0.45 %	-	-	-
TRUPS	30,928	533	2.30 %	30,928	526	2.27 %
Total Borrowed Funds	55,367	585	1.41 %	39,104	542	1.85 %
Total Interest Bearing Liabilities	1,069,004	1,930	0.24 %	906,345	2,156	0.32 %
Demand deposits- non interest bearing	410,955			347,941		
Other liabilities	15,101			17,416		
Shareholders' equity	188,285			186,050		

Total liabilities and shareholders' equity	$1,683,345				$1,457,752		
Interest Income/Interest Earning Assets			4.15	%		4.23	%
Interest Expense/Interest Earning Assets			0.17	%		0.22	%
Net Interest Income and Margin[6]		$44,613	3.98	%	$38,455	4.01	%

(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 utilizing a 35% effective tax rate.

(3) Annualized

(4) Loan costs have been included in the calculation of interest income. Loan costs were approximately $(303) thousand and $608 thousand for the nine months ended September 30, 2015 and 2014. Loans are gross of the allowance for possible loan losses.

(5) Non-accrual loans have been included in total loans for purposes of total earning assets.

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

38

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 increase or decrease 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)	Three months ended September 30, 2015 over 2014 Increase(decrease) due to			Nine months ended September 30, 2015 over 2014 Increase(decrease) due to		
	Volume	Rate	Net	Volume	Rate	Net
Assets:						
Investments:						
Federal funds sold / Due from time	$ 3	$ -	$ 3	$ (30)	$ 1	$ (29)
Taxable	228	(389)	(161)	880	(398)	482
Non-taxable[1]	19	(2)	17	46	(47)	(1)
Total Investments	250	(391)	(141)	896	(444)	452
Loans and Leases:						
Real Estate	1,281	(76)	1,205	3,850	(428)	3,422
Agricultural	69	33	102	150	28	178
Commercial	87	47	134	334	164	498
Consumer	(93)	22	(71)	(294)	98	(196)
Mortgage Warehouse	439	(134)	305	2,057	(521)	1,536
Direct Financing Leases	(6)	(1)	(7)	(18)	(2)	(20)
Other	78	(59)	19	210	(148)	62
Total Loans and Leases	1,855	(168)	1,687	6,289	(809)	5,480
Total Interest Earning Assets	$ 2,105	$ (559)	$ 1,546	$ 7,185	$ (1,253)	$ 5,932
Liabilities						
Interest Bearing Deposits:						
Demand Deposits	$ 15	$ 6	$ 21	$ 36	$ 25	$ 61
NOW	14	(12)	2	53	(48)	5
Savings Accounts	11	(1)	10	42	(83)	(41)
Money Market	7	(4)	3	30	(26)	4
CDAR's	(1)	(5)	(6)	(3)	(15)	(18)
Certificates of Deposit < $100,000	-	(20)	(20)	(1)	(70)	(71)
Certificates of Deposit ≥ $100,000	17	(55)	(38)	36	(184)	(148)
Brokered Deposits	(23)	-	(23)	(62)	1	(61)
Total Interest Bearing Deposits	40	(91)	(51)	131	(400)	(269)
Borrowed Funds:						
Federal Funds Purchased	-	-	-	-	-	-
Repurchase Agreements	5	-	5	7	4	11
Short Term Borrowings	-	1	1	9	7	16
Long Term Borrowings	-	2	2	-	9	9
TRUPS	-	4	4	-	7	7

Total Borrowed Funds	5	7	12	16	27	43
Total Interest Bearing Liabilities	45	(84)	(39)	147	(373)	(226)
Net Interest Margin/Income	$ 2,060	$ (475)	$ 1,585	$ 7,038	$ (880)	$ 6,158

(1) Yields on tax exempt income have not been computed on a tax equivalent basis.

39

The volume variance calculated for the third quarter of 2015 relative to the third quarter of 2014 was a favorable $2.060 million, due primarily to a $203 million increase in the average balance of interest-earning assets resulting from our acquisition of Santa Clara Valley Bank, organic growth, and loan purchases. The volume variance for the comparative quarters was enhanced by the fact that the average balance of loans grew by 17% relative to only 10% growth in the average balance of lower-yielding investments, but was unfavorably impacted by the fact that much of the growth in average loan balances occurred in lower-yielding mortgage warehouse loans.

The rate variance for the quarter over quarter comparison was an unfavorable $475,000, due in part to a drop of 15 basis points in our yield on earning assets relative to a decline of only five basis points in the cost of interest-bearing liabilities. Investment yields have dropped due to the reinvestment of portfolio cash flows in a historically low interest rate environment, and the weighted average yield on loans was lower due to the impact of continued competition on loan rates and relatively robust growth in lower-yielding mortgage warehouse loans. Our weighted average cost of interest-bearing liabilities was lower for the quarter primarily because of lower deposit rates. The unfavorable rate variance was exacerbated by the allocation of the variance attributable to both rate and volume changes (as per the calculations noted above), and also by the volume differential between our interest-earning assets and interest-bearing liabilities. That differential averaged $426 million for the third quarter of 2014, the base period for the rate variance calculation, thus the decrease in our earning asset yield was applied to a much higher balance than the rate decrease for interest-bearing liabilities and had a greater impact on net interest income.

The Company's net interest margin, which is tax-equivalent net interest income as a percentage of average interest-earning assets, is affected by the same factors discussed above relative to rate and volume variances. Our net interest margin was 3.90% in the third quarter of 2015, a drop of 11 basis points relative to the third quarter of 2014. The principal developments impacting our net interest margin in the third quarter of 2015 include lower yields on loans and investments, and a shift within loans to lower-yielding loan segments. Lower deposit rates helped partially offset those negative factors. Nonrecurring interest income, primarily in the form of interest recovered on non-accrual loans (net of interest reversed on loans placed on non-accrual status), totaled $102,000 in the third quarter of 2015 relative to $135,000 in the third quarter of 2014.

For net interest income in the first nine months of 2015 relative to the first nine months of 2014, a favorable variance of $7.038 million attributable to volume changes was partially offset by an unfavorable rate variance of $880,000. The volume variance for the year-to-date period was due primarily to a $216 million increase in average interest-earning assets, which was enhanced by a shift from Federal Reserve Bank balances into investment securities and strong growth in the average balance of loans relative to investments. While our cost of interest-bearing liabilities and our yield on earning assets were both down by eight basis points for the comparative year-to-date periods, there was a negative rate variance because the decrease in our yield on earning assets was applied to a much higher balance than the rate decrease for interest-bearing liabilities and had a greater impact on net interest income, and because the variance attributable to both rate and volume changes was allocated to the rate variance. The weighted average yield on interest-earning assets dropped due to lower loan yields resulting from continued competition for quality loans. However, partially alleviating the negative pressures on loan rates for the year-to-date period was higher non-recurring interest income such as net interest recovered on non-accrual loans and prepayment penalties, which totaled $513,000 in the first nine months of 2015 relative to $423,000 in the first nine months of 2014. The Company's net interest

margin for the first nine months of 2015 was 3.98%, three basis points lower than our net interest margin for the first nine months of 2014.

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 the provision for loan and lease losses. A loan loss provision has not been necessary thus far in 2015 and a provision was not recorded in the third quarter of 2014, but there was a loan loss provision of $350,000 for the first nine months of 2014.

The Company's loan loss provision has been sufficient 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. Net loans charged off by the Company totaled $137,000 in the third quarter of 2015 relative to $622,000 in the third quarter of 2014, for a reduction of $485,000, or 78%, and net charge-offs were $836,000 in the first nine months of 2015 relative to $1.015 million in the first nine months of 2014, for a reduction of $179,000, or 18%. A loan loss provision has not been recorded in 2015 due to the following factors: loan charge-offs were primarily recorded against reserves established in previous periods and did not necessitate reserve replenishment; loan growth occurred in portfolio segments with low historical loss rates; and, credit quality improvement was evident in the remainder of the loan portfolio.

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 12 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.

NON-INTEREST INCOME and NON-INTEREST expense

The following table provides details on the Company's non-interest income and non-interest expense for the three-month and nine-month periods ended September 30, 2015 and 2014 (dollars in thousands):

Non Interest Income/Expense

(dollars in thousands, unaudited)

	For the three months ended September 30,				For the nine months ended September 30,			
	2015	% of Total	2014	% of Total	2015	% of Total	2014	% of Total
NON-INTEREST INCOME:								
Service charges on deposit accounts	$2,611	61.28 %	$2,214	58.49 %	$6,880	53.24 %	$6,139	53.34 %
Other service charges, commissions & fees	1,714	40.23 %	1,538	40.63 %	5,186	40.13 %	4,630	40.23 %
Gains on securities	108	2.53 %	-	-	431	3.34 %	287	2.49 %
Bank owned life insurance	(93)	-2.18 %	156	4.12 %	495	3.83 %	844	7.33 %
Other	(79)	-1.86 %	(123)	-3.24 %	(70)	-0.54 %	(390)	-3.39 %
Total non-interest income	$4,261	100.00 %	$3,785	100.00 %	$12,922	100.00 %	$11,510	100.00 %
As a % of average interest-earning assets [(1)]		1.09 %		1.11 %		1.12 %		1.16 %
OTHER OPERATING EXPENSE:								
	$5,904	48.06 %	$5,459	46.46 %	$18,924	49.16 %	$16,772	50.09 %

Salaries and employee benefits												
Occupancy costs												
Furniture & equipment	515	4.19	%	458	3.90	%	1,527	3.97	%	1,378	4.12	%
Premises	1,319	10.74	%	1,204	10.25	%	3,633	9.44	%	3,322	9.92	%
Advertising and marketing costs	425	3.46	%	468	3.98	%	1,671	4.34	%	1,679	5.01	%
Data processing costs	791	6.44	%	673	5.73	%	2,488	6.46	%	1,937	5.78	%
Deposit services costs	872	7.10	%	657	5.59	%	2,421	6.29	%	1,935	5.78	%
Loan services costs												
Loan processing	259	2.11	%	572	4.87	%	743	1.93	%	1,033	3.08	%
Foreclosed assets	(64)	-0.52	%	51	0.43	%	173	0.45	%	(334)	-1.00	%
Other operating costs												
Telephone & data communications	455	3.70	%	329	2.80	%	1,435	3.73	%	804	2.40	%
Postage & mail	287	2.34	%	221	1.88	%	739	1.92	%	571	1.71	%
Other	210	1.70	%	147	1.25	%	588	1.53	%	499	1.49	%
Professional services costs												
Legal & accounting	405	3.30	%	310	2.64	%	1,114	2.89	%	952	2.84	%
Other professional service	255	2.08	%	744	6.33	%	1,299	3.37	%	1,791	5.35	%
Stationery & supply costs	361	2.94	%	331	2.82	%	1,022	2.65	%	859	2.57	%
Sundry & tellers	291	2.36	%	126	1.07	%	719	1.87	%	288	0.86	%
Total non-interest expense	$12,285	100.00	%	$11,750	100.00	%	$38,496	100.00	%	$33,486	100.00	%
As a % of average interest-earning assets [1]		3.13	%		3.45	%		3.35	%		3.39	%
Efficiency Ratio [2]	63.38 %			66.94 %			65.74 %			65.25 %		

(1) Annualized
(2) Tax Equivalent

41

Total non-interest income rose by $476,000, or 13%, for the quarterly comparison and $1.412 million, or 12%, for the comparative year-to-date periods due in large part to a higher level of customer activity that generated additional fee income, investment gains, and higher dividends on restricted stock. The increases were offset in part by a drop in BOLI income and, for the third quarter, higher pass-through costs on our low-income housing tax credit investments. Total non-interest income was an annualized 1.09% of average interest-earning assets in the third quarter of 2015 relative to 1.11% in the third quarter of 2014, and was 1.12% for the first nine months of 2015 relative to 1.16% for the first nine months of 2014. The lower ratio is due to an increase in average interest-earning assets.

Service charge income on deposits increased by $397,000, or 18%, for the quarterly comparison and by $741,000, or 12%, for the year-to-date comparison due primarily to fees earned from increased activity on commercial accounts and higher overdraft income. The year-to-date comparison was also favorably impacted by certain non-recurring fee waivers made in the course of our core software conversion in the first quarter of 2014. Other service charges, commissions, and fees increased by $176,000, or 11%, for the third quarter and $556,000, or 12%, for the first nine months, largely as a result of higher debit card interchange income and increases in other activity-based fees. Gains realized on the sale of investment securities totaled $108,000 in the third quarter of 2015 relative to no investment gains in the third quarter of 2014. For the first nine months, investment gains totaled $431,000 in 2015 compared to $287,000 in 2014, for an increase of $144,000.

Bank-owned life insurance ("BOLI") income was down $249,000 in the third quarter of 2015 relative to the third quarter of 2014, and also dropped by $349,000 for the year-to-date comparison mainly due to fluctuations in income on BOLI associated with deferred compensation plans. The Company owns and derives income from two basic types of BOLI: "general account" and "separate account." At September 30, 2015 the Company had $39.0 million invested in single-premium general account BOLI, which generates income that is used to fund 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 and the income is typically fairly consistent, but rate reductions have led to slightly lower income levels in recent periods. In addition to general account BOLI the Company had $4.6 million invested in separate account BOLI at September 30, 2015, which produces income that helps offset deferred compensation accruals for certain directors and senior officers. These deferred compensation BOLI 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). There was a loss on separate account BOLI totaling $337,000 in the third quarter of 2015 relative to a loss of $82,000 in the third quarter of 2014, for a quarter over quarter drop of $255,000 in deferred compensation BOLI income. For the first nine months, there was a $229,000 loss in 2015 compared to a gain of $115,000 in 2014, for an absolute difference of $344,000. 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 impact on taxable income tends to be neutral.

The "Other" category under non-interest income reflects net favorable changes of $44,000 for the quarter and $320,000 for the year-to-date period. This category includes gains and losses on the disposition of assets other than OREO, rent on bank-owned property other than OREO, dividends on restricted stock, and other miscellaneous income. Pass-through expenses associated with our investments in low-income housing tax credit funds are netted against this

income category. Income generated through the Company's alliance with Investment Centers of America ("ICA") has also been included in other non-interest income, but the Company terminated its affiliation with ICA effective July 31, 2014 so related income was down $10,000 for the third quarter of 2015 compared to the third quarter of 2014, and also declined $68,000 for the comparative year-to-date periods. However, dividends on restricted stock increased by $110,000 for the quarter and $428,000 for the first nine months, with the year-to-date increase including a $245,000 special dividend received on our FHLB stock in the second quarter of 2015 and the quarterly increase resulting from dividends received on another illiquid equity investment. Pass-through expenses on our low-income housing tax credit funds increased by $58,000 for the third quarter comparison and thus partially offset income increases in other areas, but these expenses were down slightly for the first nine months.

Total non-interest expense increased by $535,000, or 5%, in the third quarter of 2015 relative to the third quarter of 2014, and $5.010 million, or 15%, for the first nine months of 2015 in comparison to the first nine months of 2014. As detailed below the largest increases are in personnel costs, telecommunications expense, other ongoing operating costs incidental to our November 2014 acquisition and February 2014 core banking system conversion, debit card losses, and, for the year-to-date comparison, net expenses associated with foreclosed assets and data processing costs. Despite higher overhead expenses, total non-interest expense dropped to an annualized 3.13% of average interest-earning assets in the third quarter of 2015 from 3.45% in the third quarter of 2014 due to a sizeable increase in the denominator. For the first nine months, the ratio fell to 3.35% in 2015 from 3.39% for 2014.

The largest component of non-interest expense, salaries and employee benefits, increased by $445,000, or 8%, for the quarter and $2.152 million, or 13%, for the first nine months due primarily to personnel increases associated with our acquisition, regular annual salary increases, strategic additions to business development staff in 2015, an increased accrual for Company contributions to the employee 401(k) retirement plan, and higher group health insurance premiums. A higher level of deferred salaries directly related to successful loan originations partially offset the increase in other compensation costs in 2015, and the year-to-date comparison was also favorably impacted by a drop in temporary help and overtime costs related to the impact of our core banking system conversion in the first quarter of 2014. The change in salaries and benefits benefitted further from lower deferred compensation accruals in 2015, associated with the aforementioned drop in BOLI income. We recorded a deferred compensation expense reversals of $93,000 in the third quarter of 2015 and $44,000 in the third quarter of 2014 due to losses on employee deferred compensation plans, for a quarter-over-quarter reduction of $49,000 in compensation costs. For the first nine months of 2015 there was also a net deferred compensation expense accrual reversal of $27,000, but an expense accrual of $105,000 was recorded for the first nine months of 2014 for an absolute difference of $132,000 between the comparative periods. Despite their overall dollar increase, salaries and benefits dropped as a percentage of total non-interest expense for the comparative year-to-date periods due to a higher percentage increase in total non-interest expense.

Occupancy expense increased by $172,000 for the quarter and $460,000 for the year-to-date period, representing increases of 10% for both periods due primarily to the three branches added via our acquisition in November 2014 and our loan production office opened in May 2015, with associated expenses including but not limited to rent and depreciation, utilities, janitorial, and security. Marketing costs were down $43,000, or 9%, for the third quarter but were about the same for the first nine months of 2015 relative to 2014. Data processing costs were up $118,000, or 18%, for the third quarter due to ongoing costs related to the acquisition and our loan production office, and they increased $551,000, or 28%, for the year-to-date period as a result of an increase in our cost structure subsequent to the core processing conversion in the first quarter of 2014 and the additional offices. Total deposit services costs increased by $215,000, or 33%, for the quarterly comparison and by $486,000, or 25%, for the first nine months due in part to amortization expense on our core deposit intangible totaling $34,000 for the quarter and $101,000 for the first nine months, in addition to increases in internet banking, electronic check exchange, and debit card processing costs.

Loan processing costs were down $313,000, or 55%, for the third quarter and $290,000, or 28%, for the first nine months due primarily to lower loan sale costs and a reduction in expenditures for appraisals. Net costs associated with foreclosed assets fell by $1