AMERICAN RIVER BANKSHARES
Form 10-K
February 22, 2019

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2018
or

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission File No. 0-31525

AMERICAN RIVER BANKSHARES

(Exact name of registrant as specified in its charter)

California	68-0352144
State or other jurisdiction of incorporation or organization	(IRS Employer Identification No.)

3100 Zinfandel Drive, Rancho Cordova, California	95670
(Address of principal executive offices)	(Zip code)

Registrant’s telephone number, including area code 916-851-0123

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange On Which Registered
Common Stock, no par value	NASDAQ Global Select Market

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes o No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes o No x

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

Yes x No o

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T(§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files).

Yes x No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer", "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer o	Accelerated filer x
Non-accelerated filer o	Smaller reporting company o
	Emerging growth company o

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o

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

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter. $83,897,000.

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

As of February 20, 2019, the registrant's no par value Common Stock totaled 5,859,568 shares outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

The following documents are incorporated by reference into this Form 10-K: Part III, Items 10 through 14 from Registrant's definitive proxy statement for the 2019 annual meeting of shareholders.

AMERICAN RIVER BANKSHARES

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PART I

Item 1. Business.

Cautionary Statements Regarding Forward-Looking Statements

Certain matters discussed or incorporated by reference in this Annual Report on Form 10-K including, but not limited to, matters described in "Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations," are "forward-looking statements" within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, Section 27A of the Securities Act of 1933, as amended, and subject to the safe-harbor provisions of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements may contain words related to future projections including, but not limited to, words such as "believe," "expect," "anticipate," "intend," "may," "will," "shoul "could," "would," and variations of those words and similar words that are subject to risks, uncertainties and other factors that could cause actual results to differ significantly from those projected. Factors that could cause or contribute to such differences include, but are not limited to, the following:

- Current and future legislation and regulation promulgated by the United States Congress and actions taken by governmental agencies that may impact the U.S. financial system;
- the risks presented by economic volatility and recession, which could adversely affect credit quality, collateral values, including real estate collateral, investment values, liquidity and loan originations and loan portfolio delinquency rates;
- variances in the actual versus projected growth in assets and return on assets;
- potential loan and lease losses;
- potential expenses associated with resolving nonperforming assets;
- changes in the interest rate environment including interest rates charged on loans, earned on securities investments and paid on deposits and other borrowed funds;
- competitive effects;
- inadequate internal controls over financial reporting or disclosure controls and procedures;
- potential declines in fee and other noninterest income earned associated with economic factors;
- general economic conditions nationally, regionally, and within our operating markets could be less favorable than expected or could have a more direct and pronounced effect on us than expected and adversely affect our ability to continue internal growth at historical rates and maintain the quality of our earning assets;
- changes in the regulatory environment including increased capital and regulatory compliance requirements and government intervention in the U.S. financial system;
- changes in business conditions and inflation;
- changes in securities markets, public debt markets, and other capital markets;
- potential data processing, cybersecurity and other operational systems failures, breach or fraud;
- potential decline in real estate values in our operating markets;
- the effects of uncontrollable events such as terrorism, the threat of terrorism or the impact of military conflicts in connection with the conduct of the war on terrorism by the United States and its allies, natural disasters (including earthquakes and wildfires), and disruption of power supplies and communications;
- changes in accounting standards, tax laws or regulations and interpretations of such standards, laws or regulations;
- projected business increases following any future strategic expansion could be lower than expected;
- the goodwill we have recorded in connection with acquisitions could become impaired, which may have an adverse impact on our earnings;

- our ability to comply with any regulatory orders or requirements we may become subject to;
- the effects and costs of litigation and other legal developments;
- the reputation of the financial services industry could experience deterioration, which could adversely affect our ability to access markets for funding and to acquire and retain customers; and
- the efficiencies we may expect to receive from any investments in personnel and infrastructure may not be realized.

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The factors set forth under "Item 1A-Risk Factors" in this report and other cautionary statements and information set forth in this report should be carefully considered and understood as being applicable to all related forward-looking statements contained in this report, when evaluating the business prospects of the Company and its subsidiaries.

Forward-looking statements are not guarantees of performance. By their nature, they involve risks, uncertainties and assumptions. The future results and shareholder values may differ significantly from those expressed in these forward-looking statements. You are cautioned not to put undue reliance on any forward-looking statement. Any such statement speaks only as of the date of this report, and in the case of any documents that may be incorporated by reference, as of the date of those documents. We do not undertake any obligation to update or release any revisions to any forward-looking statements, to report any new information, future event or other circumstances after the date of this report or to reflect the occurrence of unanticipated events, except as required by law. However, your attention is directed to any further disclosures made on related subjects in our subsequent reports filed with the Securities and Exchange Commission (the "SEC") on Forms 10-K, 10-Q and 8-K.

Introduction

American River Bankshares (the "Company") is a bank holding company registered under the Bank Holding Company Act of 1956, as amended. The Company was incorporated under the laws of the State of California in 1995. As a bank holding company, the Company is authorized to engage in the activities permitted under the Bank Holding Company Act of 1956, as amended, and regulations thereunder. Its principal office is located at 3100 Zinfandel Drive, Suite 450, Rancho Cordova, California 95670 and its telephone number is (916) 851-0123.

The Company owns 100% of the issued and outstanding common shares of its banking subsidiary, American River Bank, and American River Financial, a California corporation which has been inactive since its incorporation in 2003.

American River Bank was incorporated and commenced business in Fair Oaks, California, in 1983 and thereafter moved its headquarters to Sacramento, California in 1985. American River Bank operates four full service offices in Sacramento County including the main office located at 1545 River Park Drive, Suite 107, Sacramento and branch offices in Sacramento and Gold River; one full service office in Placer County, located in Roseville; two full service offices in Sonoma County in Healdsburg and Santa Rosa; and three full service offices in Amador County in Jackson, Pioneer, and Ione. In 2000, North Coast Bank was acquired by the Company as a separate bank subsidiary. Effective December 31, 2003, North Coast Bank was merged with and into American River Bank. On December 3, 2004, the Company acquired Bank of Amador located in Jackson, California. Bank of Amador was merged with and into American River Bank.

American River Bank's deposits are insured by the Federal Deposit Insurance Corporation ("FDIC") up to applicable legal limits. On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). The Dodd-Frank Act includes an increase to $250,000 as the maximum FDIC insurance limit per depositor retroactive to January 1, 2008. On November 9, 2010, the FDIC implemented a final rule to permanently increase the maximum insurance limit to $250,000 under the Dodd-Frank Act.

American River Bank does not offer trust services or international banking services and does not plan to do so in the near future. American River Bank's primary business is serving the commercial banking needs of small to mid-sized businesses within those counties listed above. American River Bank accepts checking and savings deposits, offers money market deposit accounts and certificates of deposit, makes secured and unsecured commercial, secured real estate, and other installment and term loans and offers other customary banking services. American River Bank also conducts lease financing for most types of business equipment, from computer software to heavy earth-moving equipment. American River Bank owns 100% of two inactive companies, ARBCO and American River Mortgage. ARBCO was formed in 1984 to conduct real estate development and has been inactive since 1995. American River Mortgage has been inactive since its formation in 1994.

During 2018, the Company conducted no significant activities other than holding the shares of its subsidiaries. However, it is authorized, with the prior approval of the Board of Governors of the Federal Reserve System (the “Board of Governors”), the Company’s principal regulator, to engage in a variety of activities which are deemed closely related to the business of banking.

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The common stock of the Company is registered under the Securities Exchange Act of 1934, as amended, and is listed and traded on the Nasdaq Global Select Market under the symbol "AMRB."

At December 31, 2018, the Company had consolidated assets of $688 million, net loans of $319 million, deposits of $591 million and shareholders' equity of $75 million.

General

The Company is a regional bank holding company headquartered in Sacramento County, California. The principal communities served are located in Sacramento, Placer, Yolo, El Dorado, Sonoma, and Amador counties. The Company generates most of its revenue by providing a wide range of products and services to small and middle-market businesses and individuals. The Company's principal source of revenue comes from interest income. Interest income is derived from interest and fees on loans and leases, interest on investments (principally government securities), and Federal funds sold (funds loaned on a short-term basis to other banks). For the year ended December 31, 2018, these sources comprised 65.0%, 33.4%, and 1.6%, respectively, of the Company's interest income.

American River Bank's deposits are not received from a single depositor or group of affiliated depositors, the loss of any one of which would have a materially adverse effect on the business of the Company. A material portion of American River Bank's deposits are not concentrated within a single industry or group of related industries.

As of December 31, 2018 and December 31, 2017, American River Bank held $29,000,000 in certificates of deposit for the State of California. In connection with these deposits, American River Bank is generally required to pledge securities to secure such deposits, except for the first $250,000 insured by the FDIC.

Based on the most recent information made available by the FDIC through June 30, 2018, American River Bank competes with approximately 31 other banking or savings institutions in Sacramento County, 24 in Placer County, 19 in Sonoma County and 6 in Amador County, in which American River Bank's market share of FDIC insured deposits was approximately 0.9% in the service areas of Sacramento County, 0.5% in Placer County, 0.6% in Sonoma County, and 15.8% in Amador County.

Employees

At December 31, 2018, the Company and its subsidiaries employed 101 persons on a full-time equivalent basis. The Company believes its employee relations are good.

Website Access

The Company maintains a website where certain information about the Company is posted. Through the website, its Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments thereto, as well as Section 16 Reports and amendments thereto, are available as soon as reasonably practicable after such material is electronically filed with or furnished to the SEC. These reports are free of charge and can be accessed through the address www.americanriverbank.com by accessing the *Investor Relations* link, then the *Company News* link, then the *SEC Filings* link located at that address. Once you have selected the *SEC Filings* link you will have the option to access the Section 16 Reports or the reports filed on Forms 10-K, 10-Q and 8-K by the Company by selecting the appropriate link.

Competition

General Competitive Factors

In order to compete with the major financial institutions in its primary service areas, American River Bank uses to the fullest extent possible the flexibility which is accorded by their community bank status. This includes an emphasis on specialized services, local promotional activity, and personal contacts by their respective officers, directors and employees. American River Bank also seeks to provide special services and programs for individuals in their primary service area who are employed in the agricultural, professional and business fields, such as loans for equipment, furniture, tools of the trade or expansion of practices or businesses. In the event there are customers whose loan demands exceed their respective lending limits, they seek to arrange for such loans on a participation basis with other financial institutions. Furthermore, American River Bank also assists those customers requiring services not offered by either bank to obtain such services from correspondent banks.

Commercial banks compete with savings and loan associations, credit unions, other financial institutions and other entities for funds. For instance, yields on corporate and government debt securities and other commercial paper affect the ability of commercial banks to attract and hold deposits. Commercial banks also compete for loans with savings and loan associations, credit unions, consumer finance companies, mortgage companies and other lending institutions.

Banking is a business that depends on interest rate differentials. In general, the difference between the interest rate paid by a bank to obtain their deposits and other borrowings and the interest rate received by a bank on loans extended to customers and on securities held in a bank's portfolio comprise the major portion of a bank's revenues.

The interest rate differentials of a bank, and therefore their revenues, are affected not only by general economic conditions, both domestic and foreign, but also by the monetary and fiscal policies of the United States as set by statutes and as implemented by federal agencies, particularly the Federal Reserve Board. The Federal Reserve Board can and does implement national monetary policy, such as seeking to curb inflation and combat recession, by its open market operations in United States government securities, adjustments in the amount of interest free reserves that banks and other financial institutions are required to maintain, and adjustments to the discount rates applicable to borrowing by banks from the Federal Reserve Board. These activities influence the growth of bank loans, investments and deposits and also affect interest rates charged on loans and paid on deposits. The nature and timing of any future changes in monetary policies and their impact on American River Bank is not predictable.

Competitive Data

At June 30, 2018, based on the most recent "Data Book Summary of Deposits in FDIC Insured Commercial and Savings Banks" report at that date, the competing commercial and savings banks had 168 offices in the cities of Rancho Cordova, Roseville and Sacramento, California, where American River Bank has its five Sacramento area offices, 61 offices in the cities of Healdsburg and Santa Rosa, California, where American River Bank has its two Sonoma County offices, and three offices in the cities of Jackson, Pioneer and Ione, California, where American River Bank has its three Amador County offices. Additionally, American River Bank competes with thrifts and, to a lesser extent, credit unions, finance companies and other financial service providers for deposit and loan customers.

Larger banks may have a competitive advantage because of higher lending limits and major advertising and marketing campaigns. They also perform services, such as trust services, international banking, discount brokerage and insurance services, which American River Bank is neither authorized nor prepared to offer currently. American River Bank has made arrangements with its correspondent banks and with others to provide some of these services for its customers. For borrowers requiring loans in excess of American River Bank's legal lending limits, American River Bank has offered, and intends to offer in the future, such loans on a participating basis with its correspondent banks and with other community banks, retaining the portion of such loans which is within its lending limits. As of December 31, 2018, American River Bank's aggregate legal lending limits to a single borrower and such borrower's related parties were $11,946,000 on an unsecured basis and $19,910,000 on a fully secured basis based on capital and allowable reserves of $79,641,000.

American River Bank's business is concentrated in its service area, which primarily encompasses Sacramento County, South Western Placer County, Sonoma County, and Amador County. The economy of American River Bank's service area is dependent upon government, manufacturing, tourism, retail sales, agriculture, population growth and smaller service oriented businesses.

Based upon the most recent "Data Book Summary of Deposits in FDIC Insured Commercial and Savings Banks" report dated June 30, 2018, there were 215 operating commercial and savings bank offices in Sacramento County with total deposits of $35,096,311,000. This was an increase of $2,649,213,000 compared to the June 30, 2017 balances. American River Bank held a total of $315,498,000 in deposits, representing approximately 0.9% of total commercial and savings banks deposits in Sacramento County as of June 30, 2018.

Based upon the most recent "Data Book Summary of Deposits in FDIC Insured Commercial and Savings Banks" report dated June 30, 2018, there were 94 operating commercial and savings bank offices in Placer County with total deposits of $11,214,350,000. This was a decrease of $1,018,965,000 compared to the June 30, 2017 balances. American River Bank held a total of $57,285,000 in deposits, representing approximately 0.5% of total commercial and savings banks deposits in Placer County as of June 30, 2018.

Based upon the most recent "Data Book Summary of Deposits in FDIC Insured Commercial and Savings Banks" report dated June 30, 2018, there were 122 operating commercial and savings bank offices in Sonoma County with total deposits of $14,792,617,000. This was an increase of $1,651,607,000 compared to the June 30, 2017 balances. American River Bank held a total of $86,220,000 in deposits, representing approximately 0.6% of total commercial and savings banks deposits in Sonoma County as of June 30, 2018.

Based upon the most recent "Data Book Summary of Deposits in FDIC Insured Commercial and Savings Banks" report dated June 30, 2018, there were 13 operating commercial and savings bank offices in Amador County with total deposits of $774,441,000. This was an increase of $7,812,000 compared to the June 30, 2017 balances. American River Bank held a total of $122,591,000 in deposits, representing approximately 15.8% of total commercial and savings bank deposits in Amador County as of June 30, 2018.

Supervision and Regulation

General

American River Bankshares is a bank holding company within the meaning of the Bank Holding Company Act of 1956, as amended (the "Bank Holding Company Act"), and is registered as such with, and subject to the supervision of, the Board of Governors. The Company is required to obtain the approval of the Board of Governors before it may acquire all or substantially all of the assets of any bank, or ownership or control of the voting shares of any bank if, after giving effect to such acquisition of shares, the Company would own or control more than 5% of the voting shares of such bank. The Bank Holding Company Act prohibits the Company from acquiring any voting shares of, or interest in, all or substantially all of the assets of, a bank located outside the State of California unless such an acquisition is specifically authorized by the laws of the state in which such bank is located. Any such interstate acquisition is also subject to applicable California and federal law.

The common stock of the Company is subject to the registration requirements of the Securities Act of 1933, as amended, and the qualification requirements of the California Corporate Securities Law of 1968, as amended. The Company is also subject to the periodic reporting requirements of Section 13 of the Securities Exchange Act of 1934, as amended, which include, but are not limited to, annual, quarterly and other current reports with the SEC.

The Company, and any subsidiaries which it may acquire or organize, are deemed to be "affiliates" within the meaning of that term as defined in the Federal Reserve Act. This means, for example, that there are limitations (a) on loans by American River Bank to affiliates, (b) on investments by American River Bank in affiliates' stock as collateral for loans to any borrower, and (c) other transactions between any bank subsidiary and the Company. The Company and its subsidiaries are also subject to certain restrictions with respect to engaging in the underwriting, public sale and distribution of securities.

American River Bank is licensed by the California Commissioner (the "Commissioner") of the Department of Business Oversight (the "DBO"), and its deposits are insured by the FDIC up to the applicable legal limits. American River Bankshares and American River Bank are required to file reports with the Board of Governors, the Commissioner, and the FDIC and provide any additional information that the Board of Governors, the Commissioner, and the FDIC may require.

Capital Standards

Federal regulations require FDIC insured depository institutions, including state-chartered banks, to meet several minimum capital standards: a common equity Tier 1 capital to risk-based assets ratio, a Tier 1 capital to risk-based assets ratio, a total capital to risk-based assets and a Tier 1 capital to total assets leverage ratio. The existing capital requirements were effective January 1, 2015 and are the result of a final rule implementing regulatory amendments based on recommendations of the Basel Committee on Banking Supervision and certain requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act”).

The capital standards require the maintenance of common equity Tier 1 capital, Tier 1 capital and total capital to risk-weighted assets of at least 4.5%, 6% and 8%, respectively, and a leverage ratio of at least 4% Tier 1 capital. Common equity Tier 1 capital is generally defined as common stockholders' equity and retained earnings. Tier 1 capital is generally defined as common equity Tier 1 and Additional Tier 1 capital. Additional Tier 1 capital generally includes certain noncumulative perpetual preferred stock and related surplus and minority interests in equity accounts of consolidated subsidiaries. Total capital includes Tier 1 capital (common equity Tier 1 capital plus Additional Tier 1 capital) and Tier 2 capital. Tier 2 capital is comprised of capital instruments and related surplus meeting specified requirements, and may include cumulative preferred stock and long-term perpetual preferred stock, mandatory convertible securities, intermediate preferred stock and subordinated debt. Also included in Tier 2 capital is the allowance for loan and lease losses limited to a maximum of 1.25% of risk-weighted assets and, for institutions that have exercised an opt-out election regarding the treatment of Accumulated Other Comprehensive Income ("AOCI"), up to 45% of net unrealized gains on available-for-sale equity securities with readily determinable fair market values. Institutions that have not exercised the AOCI opt-out have AOCI incorporated into common equity Tier 1 capital (including unrealized gains and losses on available-for-sale-securities). We exercised the opt-out election regarding the treatment of AOCI. Calculation of all types of regulatory capital is subject to deductions and adjustments specified in the regulations.

In determining the amount of risk-weighted assets for purposes of calculating risk-based capital ratios, a bank's assets, including certain off-balance sheet assets (e.g., recourse obligations, direct credit substitutes, residual interests), are multiplied by a risk weight factor assigned by the regulations based on perceived risks inherent in the type of asset. Higher levels of capital are required for asset categories believed to present greater risk. For example, a risk weight of 0% is assigned to cash and U.S. government securities, a risk weight of 50% is generally assigned to prudently underwritten first lien 1 – 4 family residential mortgages, a risk weight of 100% is assigned to commercial and consumer loans, a risk weight of 150% is assigned to certain past due loans and a risk weight of between 0% to 600% is assigned to permissible equity interests, depending on certain specified factors.

In addition to establishing the minimum regulatory capital requirements, the regulations limit capital distributions and certain discretionary bonus payments to management if the institution does not hold a "capital conservation buffer" consisting of 2.5% of common equity Tier 1 capital to risk-weighted assets above the amount necessary to meet its minimum risk-based capital requirements. The capital conservation buffer requirement was phased in beginning January 1, 2016 at 0.625% of risk-weighted assets and increasing each year until now fully implemented at 2.5% as of January 1, 2019.

Management believes that American River Bank is in compliance with the minimum capital requirements, including the fully phased-in capital conservation buffer requirement based upon its capital position at December 31, 2018.

In accordance with the Dodd-Frank Act and long-standing Federal Reserve policy, the Company must act as a source of financial and managerial strength to American River Bank. Under this policy, the Company must commit resources to support the Bank, including at times when the Company may not be in a financial position to provide it. The Company could be required to guarantee the capital plan of American River Bank if it becomes undercapitalized for purposes of banking regulations, as described below. Any capital loans by a bank holding company to its subsidiary bank are subordinate in right of payment to deposits and to certain other indebtedness of such subsidiary bank. The Bank Holding Company Act of 1956, as amended (the "BHC Act") provides that, in the event of a bank holding company's bankruptcy, any commitment by the bank holding company to a federal bank regulatory agency to maintain the capital of a bank subsidiary will be assumed by the bankruptcy trustee and entitled to priority of payment.

Safety and Soundness Standards

Each federal banking agency, including the FDIC, has adopted guidelines establishing general standards relating to internal controls, information and internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, asset quality, earnings, compensation, fees and benefits and information security standards. In general, the guidelines require appropriate systems and practices to identify and manage the risks and exposures specified in the guidelines. The guidelines prohibit excessive compensation as an unsafe and unsound practice and describe compensation as excessive when the amounts paid are unreasonable or disproportionate to the services performed by an executive officer, employee, director, or principal stockholder. The FDIC also has issued guidance on risks banks may face from third party relationships (e.g. relationships under which the third party provides services to the bank). The guidance generally requires the bank to perform adequate due diligence on the third party, appropriately document the relationship, and perform adequate oversight and auditing, in order to the limit the risks to the bank.

Prompt Corrective Regulatory Action

Federal law requires that federal bank regulatory authorities take “prompt corrective action” with respect to institutions that do not meet minimum capital requirements. For these purposes, the statute establishes five capital tiers: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized.

State banks that have insufficient capital are subject to certain mandatory and discretionary supervisory measures. For example, a bank that is “undercapitalized” (i.e. fails to comply with any regulatory capital requirement) is subject to growth limitations and is required to submit a capital restoration plan; a holding company that controls such a bank is required to guarantee that the bank complies with the restoration plan. A “significantly undercapitalized” bank is subject to additional restrictions. State banks deemed by the FDIC to be “critically undercapitalized” are subject to the appointment of a receiver or conservator.

The final rule that increased regulatory capital standards also adjusted the prompt corrective action tiers as of January 1, 2015 to conform to the new capital standards. The various categories now incorporate the newly adopted common equity Tier 1 capital requirement, an increase in the Tier 1 to risk-based assets requirement and other changes. Under the revised prompt corrective action requirements, insured depository institutions are required to meet the following in order to qualify as “well capitalized:” (1) a common equity Tier 1 risk-based capital ratio of 6.5% (new standard); (2) a Tier 1 risk-based capital ratio of 8% (increased from 6%); (3) a total risk-based capital ratio of 10% (unchanged) and (4) a Tier 1 leverage ratio of 5% (unchanged).

Additional Regulations

Under the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), the federal financial institution agencies have adopted regulations which require institutions to establish and maintain comprehensive written real estate policies which address certain lending considerations, including loan-to-value limits, loan administrative policies, portfolio diversification standards, and documentation, approval and reporting requirements. The FDICIA further generally prohibits an insured state bank from engaging as a principal in any activity that is impermissible for a national bank, absent FDIC determination that the activity would not pose a significant risk to the Bank Insurance Fund, and that the bank is, and will continue to be, within applicable capital standards.

The Federal Financial Institution Examination Counsel (“FFIEC”) utilizes the Uniform Financial Institutions Rating System (“UFIRS”) commonly referred to as “CAMELS” to classify and evaluate the soundness of financial institutions. Bank examiners use the CAMELS measurements to evaluate capital adequacy, asset quality, management, earnings, liquidity and sensitivity to market risk. Effective January 1, 2005, bank holding companies such as the Company, were subject to evaluation and examination under a revised bank holding company rating system. The so-called BOPEC rating system implemented in 1979 was primarily focused on financial condition, consolidated capital and consolidated earnings. The rating system reflects the change toward analysis of risk management (as reflected in bank examination under the CAMELS measurements), in addition to financial factors and the potential impact of nondepository subsidiaries upon depository institution subsidiaries.

The federal financial institution agencies have established bases for analysis and standards for assessing a financial institution's capital adequacy in conjunction with the risk-based and Basel III capital guidelines including analysis of interest rate risk, concentrations of credit risk, risk posed by non-traditional activities, and factors affecting overall safety and soundness. The safety and soundness standards for insured financial institutions include analysis of (1) internal controls, information systems and internal audit systems; (2) loan documentation; (3) credit underwriting; (4) interest rate exposure; (5) asset growth; (6) compensation, fees and benefits; and (7) excessive compensation for executive officers, directors or principal shareholders which could lead to material financial loss. If an agency determines that an institution fails to meet any standard, the agency may require the financial institution to submit to the agency an acceptable plan to achieve compliance with the standard. If the agency requires submission of a compliance plan and the institution fails to timely submit an acceptable plan or to implement an accepted plan, the agency must require the institution to correct the deficiency. The agencies may elect to initiate enforcement action in certain cases rather than rely on an existing plan particularly where failure to meet one or more of the standards could threaten the safe and sound operation of the institution.

Community Reinvestment Act ("CRA") regulations evaluate banks' lending to low and moderate income individuals and businesses across a four-point scale from "outstanding" to "substantial noncompliance," and are a factor in regulatory review of applications to merge, establish new branches or form bank holding companies. In addition, any bank rated in "substantial noncompliance" with the CRA regulations may be subject to enforcement proceedings. In its most recent exam for CRA compliance, American River Bank has a rating of "satisfactory."

Limitations on Dividends, Repurchases and Redemptions

The Company's ability to pay cash dividends is subject to restrictions set forth in the California General Corporation Law. Funds for payment of any cash dividends by the Company would be obtained from its investments as well as dividends and/or management fees from its subsidiaries. The payment of cash dividends and/or management fees by American River Bank is subject to restrictions set forth in the California Financial Code, as well as restrictions established by the FDIC. On January 25, 2017, the Board of Directors resumed the payment of cash dividends. The Company relies on distributions from American River Bank in the form of cash dividends in order to pay cash dividends to our shareholders. See Item 5. "Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities" for more information regarding cash dividends. We cannot provide any assurance that we will be able to pay dividends in the future.

It is an essential principle of safety and soundness that a banking organization's redemption and repurchases of regulatory capital instruments, including common stock, from investors be consistent with the organization's current and prospective capital needs. Consultation with the Federal Reserve before redeeming any equity or other capital instrument included in Tier 1 or Tier 2 capital is generally advisable in all circumstances and is required if such redemption could have a material effect on the level or composition of the organization's capital base. Bank holding companies that are experiencing financial weaknesses, or that are at significant risk of developing financial weaknesses, must consult with the appropriate Federal Reserve supervisory staff before redeeming or repurchasing common stock or other regulatory capital instruments for cash or other valuable consideration. Similarly, any bank holding company considering expansion, whether through acquisitions or through organic growth and new activities, generally also must consult with the appropriate Federal Reserve supervisory staff before redeeming or repurchasing common stock or other regulatory capital instruments for cash or other valuable consideration. In evaluating the appropriateness of a bank holding company's proposed redemption or repurchase of capital instruments, the Federal Reserve will consider the potential losses that the holding company may suffer from the prospective need to increase reserves and write down assets from continued asset deterioration and the holding company's ability to raise additional common stock and other Tier 1 capital to replace capital instruments that are redeemed or repurchased. A bank holding company must inform the Federal Reserve of a redemption or repurchase of common stock or perpetual preferred stock for cash or other value resulting in a net reduction of the bank holding company's outstanding amount of common stock or perpetual preferred stock below the amount of such capital instrument outstanding at the beginning of the quarter in which the redemption or repurchase occurs. In addition, a bank holding company must advise the Federal Reserve sufficiently in advance of such redemptions and repurchases to provide reasonable opportunity for supervisory review and possible objection should the Federal Reserve determine a transaction raises safety and soundness concerns.

Bank holding company that are not well capitalized or well managed, or that are subject to any unresolved supervisory issues, must provide prior notice to the Federal Reserve for any repurchase or redemption of its equity securities for cash or other value that would reduce by 10% or more the holding company's consolidated net worth aggregated over the preceding 12-month period.

FDIC Insurance

On October 3, 2008, the Emergency Economic Stabilization Act of 2008 (the "EESA") was signed into law. The EESA temporarily raised the limit on federal deposit insurance coverage provided by the FDIC from $100,000 to $250,000 per depositor. On July 21, 2010, President Obama signed the Dodd-Frank Act into law. On November 9, 2010, the FDIC issued a final rule implementing section 343 of the Dodd-Frank Act that permanently raised the current standard maximum deposit insurance amount per depositor to $250,000. In addition, the Dodd-Frank Act also made other deposit insurance changes which may affect our insurance premium assessments to include (i) amendment of the assessment base used to calculate an insured depository institution's deposit insurance premiums paid to the DIF by elimination of deposits and substitution of average consolidated total assets less average tangible equity during the assessment period as the revised assessment base; (ii) increasing the minimum designated reserve ratio of the DIF from 1.15 percent to 1.35 percent of the estimated amount of total insured deposits; (iii) eliminating the requirement that the FDIC pay dividends to depository institutions when the reserve ratio exceeds certain thresholds; and (iv) repeal of the prohibition upon the payment of interest on demand deposits to be effective one year after the date of enactment of the Dodd-Frank Act.

On November 18, 2014, the FDIC adopted the Assessments Final Rule which revises the FDIC's risk-based deposit insurance assessment system to reflect changes in the regulatory capital rules adopted by the federal banking agencies as part of the so-called Basel III capital regulations to conform the prompt corrective action capital ratios and ratio thresholds for "well capitalized" and "adequately capitalized" evaluations.

On June 16, 2015, the FDIC proposed changes to the deposit insurance assessments for small insured banks having total assets less than $10 Billion which have been insured for at least five years, based upon experience with bank failures. The changes, among other matters, revise the financial ratios method of determining assessments to reflect a statistical model estimating the probability of failure over three years and updating the financial measures used in the financial ratios method consistent with the statistical model. The FDIC proposed additional changes on October 22, 2015 to require banks with over $10 Billion in assets to be responsible for the recapitalization of the DIF to 1.35 percent of insured deposits after achieving a 1.15 percent reserve ratio. On January 21, 2016, the FDIC proposed further revisions to the small insured bank assessments as the result of comments and recommendations received in response to its earlier proposal. The FDIC proposed that a final rule would go into effect the quarter after adoption, but the amendments would not become operative until the quarter after the DIF reserve ratio reached 1.15 percent. The DIF achieved a reserve ratio of 1.17 as of June 30, 2016. Among the effects of the amendments was a reduction in the initial assessment rates for all banks. On September 30, 2018, the DIF reached 1.36%. Because the reserve ratio has exceeded 1.35%, two deposit insurance assessment changes occurred under the FDIC regulations: 1) surcharges on large banks (total consolidated assets of $10 billion or more) ended; the last surcharge on large banks was collected on December 28, 2018. and 2) small banks (total consolidated assets of less than $10 billion) were awarded assessment credits for the portion of their assessments that contributed to the growth in the reserve ratio from 1.15% to 1.35%, to be applied when the reserve ratio is at least 1.38%.

Although American River Bank's recent assessments have declined as a result of the change to the deposit assessment system, it is uncertain what effect the implementation of the changes to the insurance assessments will have upon the Company's cost of operations in the future, but a deterioration in the economic conditions impacting financial institutions or a significant number of failed institutions might necessitate increases in premium assessments to maintain the DIF which could adversely impact the Company's earnings.

Impact of Certain Legislation and Regulation

Interstate Banking. The Dodd-Frank Act signed into law by President Obama on July 21, 2010, includes provisions authorizing national and state banks to establish branch offices in other states to the same extent as a bank chartered by that state would be permitted to branch. Previously, banks could only establish branch offices in other states if the host state expressly permitted out-of-state banks to establish branch offices in that state. Accordingly, banks may be able to enter new markets more freely.

Gramm-Leach-Bliley Act. In 1999, the Gramm-Leach-Bliley Act (the "GLB Act") was signed into law. The GLB Act eliminated most of the remaining depression-era "firewalls" between banks, securities firms and insurance companies which were established by The Banking Act of 1933, also known as the Glass-Steagall Act ("Glass-Steagall"). Glass-Steagall sought to insulate banks as depository institutions from the perceived risks of securities dealing and underwriting, and related activities. The GLB Act permitted bank holding companies that could qualify as "financial holding companies" to acquire securities firms or create them as subsidiaries, and securities firms could acquire banks or start banking activities through a financial holding company. Prior to the GLB Act, banks were also (with minor exceptions) prohibited from engaging in insurance activities or affiliating with insurers. The GLB Act removed these restrictions and substantially eliminated the prohibitions under the Bank Holding Company Act on affiliations between banks and insurance companies. Consequently, the common ownership of banks, securities firms and insurance firms was possible, in addition to the conduct of commercial banking, merchant banking, investment management, securities underwriting and insurance within a single financial institution using a "financial holding company" structure authorized by the GLB Act.

A bank holding company could qualify as a financial holding company if (i) its banking subsidiaries are "well capitalized" and "well managed" and (ii) it files with the Board of Governors a certification to such effect and a declaration that it elects to become a financial holding company. The Bank Holding Company Act was amended to permit financial holding companies to engage in activities, and acquire companies engaged in activities, that are financial in nature or incidental to such financial activities. Financial holding companies were also permitted to engage in activities that were complementary to financial activities if the Board of Governors determined that the activity did not pose a substantial risk to the safety or soundness of depository institutions or the financial system in general. These standards expanded upon the list of activities "closely related to banking" which have defined the permissible activities of bank holding companies under the Bank Holding Company Act. Neither the Company nor American River Bank has determined whether or when to seek to acquire and exercise powers or activities under the GLB Act.

Volcker Rule. On December 10, 2013, the federal banking agencies jointly issued a final rule implementing the so-called "Volcker Rule" (set forth in Section 619 of the Dodd-Frank Act). The Volcker Rule prohibits depository institutions, companies that control such institutions, bank holding companies, and the affiliates and subsidiaries of such banking entities, from engaging as principal for the trading account of the banking entity in any purchase or sale of one or more covered financial instruments (so-called "proprietary trading") and imposes limitations upon retaining ownership interests in, sponsoring, investing in and transacting with certain investment funds, including hedge funds and private equity funds. Management believes the investment portfolio and activities of American River Bank and the Company are in compliance with the Volcker Rule and its implementing regulations.

Change in Bank Control Act. Subject to various exceptions, the BHC Act and the Change in Bank Control Act, together with related regulations, require Federal Reserve approval prior to any person's or company's acquiring "control" of a bank holding company. Under a rebuttable presumption established by the Federal Reserve pursuant to the Change in Bank Control Act, the acquisition of 10% or more of a class of voting stock of a bank holding company would constitute acquisition of control of the bank holding company if no other person will own, control, or hold the power to vote a greater percentage of that class of voting stock immediately after the transaction or the bank holding company has registered securities under the Exchange Act. In addition, any person or group of persons acting in concert must obtain the approval of the Federal Reserve under the BHC Act before acquiring 25% (5% in the case of an acquirer that is already a bank holding company) or more of the outstanding voting stock of a bank holding company, the right to control in any manner the election of a majority of the company's directors, or otherwise obtaining control or a "controlling influence" over the bank holding company. The California Financial Code has similar regulations applicable to acquisition of securities of a California-chartered bank holding company and bank, such as the Company and American River Bank.

Patriot Act. On October 26, 2001, President Bush signed the USA Patriot Act (the "Patriot Act"), which includes provisions pertaining to domestic security, surveillance procedures, border protection, and terrorism laws to be administered by the Secretary of the Treasury. Title III of the Patriot Act entitled, "International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001" includes amendments to the Bank Secrecy Act which expand the responsibilities of financial institutions in regard to anti-money laundering activities with particular emphasis upon international money laundering and terrorism financing activities through designated correspondent and private banking accounts.

The Patriot Act contains various provisions that affect the operations of financial institutions by encouraging cooperation among financial institutions, regulatory authorities and law enforcement authorities with respect to individuals, entities and organizations engaged in, or reasonably suspected of engaging in, terrorist acts or money laundering activities. The Company and American River Bank are not currently aware of any account relationships between American River Bank and any foreign bank or other person or entity which would not be in compliance with the Patriot Act.

The effects which the Patriot Act and any amendments to the Patriot Act or additional legislation enacted by Congress may have upon financial institutions is uncertain; however, such legislation could increase compliance costs and thereby potentially may have an adverse effect upon the Company's results of operations.

Sarbanes-Oxley Act. On July 30, 2002, President Bush signed into law the Sarbanes-Oxley Act of 2002 (the "Act") which responded to issues in corporate governance and accountability. Among other matters, key provisions of the Act and rules promulgated by the SEC pursuant to the Act include enhancement of financial disclosures and related certification requirements, rules related to audit committees, auditor independence, ethics requirements, securities trading prohibitions, securities reporting requirements, and securities listing requirements.

The Company's securities are listed on the Nasdaq Global Select Market. Consequently, in addition to the rules promulgated by the SEC pursuant to the Act, the Company must also comply with the listing standards applicable to Nasdaq listed companies. The Nasdaq listing standards applicable to the Company include standards related to (i) director independence, (ii) executive session meetings of the board, (iii) requirements for audit, nominating and compensation committee charters, membership qualifications and procedures, (iv) shareholder approval of equity compensation arrangements, and (v) code of conduct requirements that comply with the code of ethics under the Act.

The Company has incurred and it is anticipated that it will continue to incur increased costs to comply with the Act and the rules and regulations promulgated pursuant to the Act by the SEC, Nasdaq and other regulatory agencies having jurisdiction over the Company or the issuance and listing of its securities. The Company does not currently anticipate, however, that compliance with the Act and such rules and regulations will have a material adverse effect upon its financial position or results of its operations or its cash flows.

Fair and Accurate Credit Transactions Act. The Board of Governors, the FDIC, the other federal financial institution regulatory agencies, and the Federal Trade Commission issued final rules and guidelines effective January 1, 2008, subject to mandatory compliance as of November 1, 2008, implementing sections 114 and 315 of the Fair and Accurate Credit Transactions Act of 2003 to require financial institutions and other creditors to develop and implement a written identity theft prevention program. The program must include reasonable policies and procedures for detecting, preventing, and mitigating identity theft in connection with certain new and existing covered accounts. Covered accounts are defined as (i) an account primarily for personal, family, or household purposes (i.e., consumer accounts), or (ii) any other account for which there is a reasonably foreseeable risk to customers or the safety and soundness of the financial institution or creditor from identity theft. The program must be appropriate to the size and complexity of the financial institution or creditor and the nature and scope of its activities and should be designed to:

- identify relevant patterns, practices, and specific forms of activity that are "red flags" of possible identity theft and incorporate those red flags into the program;
- detect the occurrence of red flags incorporated into the program;
- respond appropriately to any red flags that are detected to prevent and mitigate identity theft; and
- ensure that the program is updated periodically to reflect changes in risks to customers or to the safety and soundness of the financial institution or creditor from identity theft.

The regulations include guidelines that each financial institution must consider and, to the extent appropriate, include in its program and steps that must be taken to administer the program including (i) obtaining approval of the program by the board of directors or a committee of the board, (ii) ensuring oversight of the development, implementation and administration of the program, (iii) training staff, and (iv) overseeing service provider arrangements. The guidelines contemplate that existing fraud prevention procedures may be incorporated into the program.

Office of Foreign Assets Control Regulation. The United States has imposed economic sanctions that affect transactions with designated foreign countries, foreign nationals and others. These are typically known as the "OFAC" rules based on their administration by the U.S. Department of the Treasury Office of Foreign Assets Control ("OFAC"). The OFAC-administered sanctions targeting countries take many different forms. Generally, however, they contain one or more of the following elements: (i) restrictions on trade with or investment in a sanctioned country, including prohibitions against direct or indirect imports from and exports to a sanctioned country and prohibitions on "U.S. persons" engaging in financial transactions relating to making investments in, or providing investment-related advice or assistance to, a sanctioned country; and (ii) a blocking of assets in which the government or specially designated nationals of the sanctioned country have an interest, by prohibiting transfers of property subject to U.S. jurisdiction (including property in the possession or control of U.S. persons). Blocked assets (e.g., property and bank deposits) cannot be paid out, withdrawn, set off or transferred in any manner without a license from OFAC. American River Bank is responsible for, among other things, blocking accounts of, and transactions with, such targets and countries, prohibiting unlicensed trade and financial transactions with them and *reporting blocked transactions after their occurrence. Failure to comply with these sanctions could have serious legal and reputational consequences.*

The Dodd-Frank Act. On July 21, 2010, President Obama signed into law the Dodd-Frank Act. The Dodd-Frank Act is intended to restructure the regulation of the financial services sector by, among other things, (i) establishing a framework to identify systemic risks in the financial system implemented by a newly created Financial Stability Oversight Council and other federal banking agencies; (ii) expanding the resolution authority of the federal banking agencies over troubled financial institutions; (iii) authorizing changes to capital and liquidity requirements; (iv) changing deposit insurance assessments; and (v) enhancing regulatory supervision to improve the safety and soundness of the financial services sector. Below is a summary of certain provisions of the Dodd-Frank Act which, directly or indirectly, may affect us.

- *Changes to Capital Requirements.* The federal banking agencies are required to establish revised minimum leverage and risk-based capital requirements for banks and bank holding companies. The Dodd-Frank Act requires capital requirements to be counter cyclical so that the required amount of capital increases in times of economic expansion and decreases in times of economic contraction consistent with safety and soundness.
- *Enhanced Regulatory Supervision.* The Dodd-Frank Act increases regulatory oversight, supervision and examination of banks, bank holding companies and their respective subsidiaries by the appropriate regulatory agency.
- *Consumer Protection.* The Dodd-Frank Act created the Consumer Financial Protection Bureau (“CFPB”) within the Federal Reserve System. The CFPB is responsible for establishing and implementing rules and regulations under various federal consumer protection laws governing certain consumer products and services. The CFPB has primary enforcement authority over large financial institutions with assets of $10 Billion or more, while smaller institutions will be subject to the CFPB’s rules and regulations through the enforcement authority of the federal banking agencies. States are permitted to adopt consumer protection laws and regulations that are more stringent than those laws and regulations adopted by the CFPB and state attorneys general are permitted to enforce consumer protection laws and regulations adopted by the CFPB.
- *Deposit Insurance.* The Dodd-Frank Act permanently increased the deposit insurance limit for insured deposits to $250,000 per depositor. Other deposit insurance changes under the Dodd-Frank Act include (i) amendment of the assessment base used to calculate an insured depository institution’s deposit insurance premiums paid to the Deposit Insurance Fund (“DIF”) by elimination of deposits and substitution of average consolidated total assets less average tangible equity during the assessment period as the revised assessment base; (ii) increasing the minimum designated reserve ratio of the DIF from 1.15 percent to 1.35 percent of the estimated amount of total insured deposits; (iii) eliminating the requirement that the FDIC pay dividends to depository institutions when the reserve ratio exceeds certain thresholds; and (iv) repeal of the prohibition upon the payment of interest on demand deposits to be effective one year after the date of enactment of the Dodd-Frank Act. The FDIC has proposed further changes to the deposit insurance assessments applicable to small insured depository institutions with assets less than $10 Billion and additional DIF recapitalization obligations for insured depository institutions with more than $10 Billion in assets. See the discussion of these changes in “Supervision and Regulation - FDIC Insurance.”
- *Transactions with Affiliates.* The Dodd-Frank Act enhances the requirements for certain transactions with affiliates under Section 23A and 23B of the Federal Reserve Act, including an expansion of the definition of “covered transactions” and increasing the amount of time for which collateral requirements regarding covered transactions must be maintained.
- *Transactions with Insiders.* Insider transaction limitations are expanded through the strengthening of loan restrictions to insiders and the expansion of the types of transactions subject to the various limits, including derivative transactions, repurchase agreements, reverse repurchase agreements and securities lending or borrowing transactions. Restrictions are also placed on certain asset sales to and from an insider to an institution, including requirements that such sales be on market terms and, in certain circumstances, approved by the institution’s board of directors.
- *Enhanced Lending Limitations.* The Dodd-Frank Act strengthens the existing limits on a depository institution’s credit exposure to include credit exposure arising from derivative transactions, repurchase agreements, and securities lending and borrowing transactions.
- *Debit Card Interchange Fees.* The Dodd-Frank Act requires that the amount of any interchange fee charged by a debit card issuer with respect to a debit card transaction must be reasonable and proportional to the cost incurred by

the issuer. The Federal Reserve Board was required to establish standards for reasonable and proportional fees which may take into account the costs of preventing fraud. The restrictions on interchange fees, however, do not apply to banks that, together with their affiliates, have assets of less than $10 Billion.

- *Interstate Branching.* The Dodd-Frank Act authorizes national and state banks to establish branch offices in other states to the same extent as a bank chartered by that state would be permitted to branch. Previously, banks could only establish branch offices in other states if the host state expressly permitted out-of-state banks to establish branch offices in that state. Accordingly, banks may be able to enter new markets more freely.

Compensation Practices. The Dodd-Frank Act provides that the appropriate federal banking regulators must establish standards prohibiting as an unsafe and unsound practice any compensation plan of a bank holding company or other "covered financial institution" that provides an insider or other employee with "excessive compensation" or could lead to a material financial loss to such firm. In June 2016, several federal financial agencies (including the Federal Reserve and FDIC) re-proposed restrictions on incentive-based compensation pursuant to Section 956 of the Dodd-Frank Act for financial institutions with $1 billion or more in total consolidated assets. For institutions with at least $1 billion but less than $50 billion in total consolidated assets, the proposal would impose principles-based restrictions that are broadly consistent with existing interagency guidance on incentive-based compensation. Such institutions would be prohibited from entering into incentive compensation arrangements that encourage inappropriate risks by the institution (i) by providing an executive officer, employee, director, principal shareholder or individuals who are "significant risk takers" with excessive compensation, fees or benefits, or (ii) that could lead to material financial loss to the institution. Depending upon the outcome of the rule making process, the application of this rule to us if we were to cross the $1 billion threshold could require us to revise our compensation strategy, increase our administrative costs and adversely affect our ability to recruit and retain qualified associates.

In June 2010, prior to the enactment of the Dodd-Frank Act, the federal bank regulatory agencies jointly issued the *Interagency Guidance on Sound Incentive Compensation Policies* ("Guidance"), which requires that financial institutions establish metrics for measuring the risk to the financial institution of such loss from incentive compensation arrangements and implement policies to prohibit inappropriate risk taking that may lead to material financial loss to the institution. Together, the Dodd-Frank Act and the Guidance may impact our compensation policies and arrangements.

Requirements under the Dodd-Frank Act are anticipated to be implemented over an extended period of time, unless the implementation is changed as the result of additional legislation promulgated by Congress or as a result of actions taken by the administration of President Trump. Therefore, the nature and extent of regulations that will be issued by various regulatory agencies and the impact such regulations will have on the operations of financial institutions such as ours is unclear. Such regulations resulting from the Dodd-Frank Act may impact the profitability of our business activities, require changes to certain of our business practices, impose upon us more stringent capital, liquidity and leverage ratio requirements or otherwise adversely affect our business. These changes may also require us to invest significant management attention and resources to evaluate and make necessary changes in order to comply with new statutory and regulatory requirements.

2017 Tax Reform Law

On December 22, 2017, President Trump signed into law "H.R.1" commonly referred to as the Tax Cuts and Jobs Act, which among other matters reduced the federal corporate income tax rate to 21%, effective January 1, 2018. The lowering of the tax rate caused banks that carry net deferred tax assets on their balance-sheets (i.e., tax positions carried forward to offset against future taxes) to take charges against the valuation of their net deferred tax assets because the higher the tax rate, the more these net deferred tax assets are worth. Hence, the reduction of the federal corporate-tax rate from the Company's 2017 rate of 34% to the projected future rate of 21%, reduced the value of these net deferred tax assets. Charges of $1,220,000 against the Company's net deferred tax assets were recorded as additional income tax expense in the fourth quarter of 2017.

Future Legislation and Regulation

In addition to legislative changes, the various federal and state financial institution regulatory agencies frequently propose rules and regulations to implement and enforce already existing legislation. It cannot be predicted whether or in what form any such rules or regulations will be enacted or the effect that such regulations may have on American River Bankshares or American River Bank. The Company anticipates that additional regulations would likely increase the Company’s expenses, which may adversely impact the Company’s results of operations, financial condition, future prospects, profitability, and stock price.

Item 1A. Risk Factors.

The Company and its subsidiary, American River Bank, conduct business in an environment that includes certain risks described below any of which could have a material adverse effect on the Company's business, results of operations, financial condition, future prospects and stock price. You are also referred to the matters described under the heading "Cautionary Statements Regarding Forward-Looking Statements," in Part I, Item 1 and Part II, Item 7 of this report on Form 10-K for additional information regarding factors that may affect the Company's business.

- **We are subject to extensive governmental regulation, which could adversely affect our business.**

Our operations are subject to extensive regulation by federal, state and local governmental authorities and are subject to various laws and judicial and administrative decisions imposing requirements and restrictions on part or all of our operations. Because our business is highly regulated, the laws, rules and regulations applicable to us are subject to regular modification and change. The Dodd-Frank Act, among other things, imposed new capital requirements on bank holding companies; changed the base for FDIC insurance assessments to a bank's average consolidated total assets minus average tangible equity, rather than upon its deposit base; permanently raised the current standard deposit insurance limit to $250,000; and expanded the FDIC's authority to raise insurance premiums. The Dodd-Frank Act also established the Consumer Financial Protection Bureau as an independent entity within the Federal Reserve Board (FRB), which has broad rulemaking, supervisory and enforcement authority over consumer financial products and services, including deposit products, residential mortgages, home-equity loans and credit cards and contains provisions on mortgage-related matters, such as steering incentives, determinations as to a borrower's ability to repay and prepayment penalties. Although the applicability of certain elements of the Dodd-Frank Act is limited to institutions with more than $10 billion in assets, there can be no guarantee that such applicability will not be extended in the future or that regulators or other third parties will not seek to impose such requirements on institutions with less than $10 billion in assets, such as the Company. Compliance with the Dodd-Frank Act and its implementing regulations has and will continue to result in additional operating and compliance costs that could have a material adverse effect on our business, financial condition, results of operations and growth prospects. Failure to comply with the Dodd-Frank Act and any other federal, state and local governmental regulation could also result in regulatory enforcement actions which could limit or restrict our ability to conduct our operations, require us to raise capital, increase our compliance costs and expose us to reputational risk.

In addition, new proposals for legislation continue to be introduced in the U.S. Congress that could further substantially increase regulation of the bank and non-bank financial services industries and impose restrictions on the operations and general ability of firms within the industry to conduct business consistent with historical practices. Federal regulatory agencies also frequently adopt changes to their regulations or change the manner in which existing regulations are applied. Certain aspects of current or proposed regulatory or legislative changes to laws applicable to the financial industry, if enacted or adopted, may impact the profitability of our business activities, require more oversight or change certain of our business practices, including the ability to offer products, obtain financing, attract deposits, make loans and achieve satisfactory interest spreads and could expose us to additional costs, including increased compliance costs. These changes also may require us to invest significant management attention and resources to make any necessary changes to operations to comply and could have a material adverse effect on our business, financial condition and results of operations.

- **Deterioration of economic conditions could adversely affect our business.**

Our business and operations, which primarily consist of lending money to customers in the form of loans, borrowing money from customers in the form of deposits and investing in securities, are sensitive to general business and economic conditions in the United States and in Northern California, in particular. If the U.S. or California economy weakens, our growth and profitability from our lending, deposit and investment operations could be constrained or impeded. Uncertainty about the federal fiscal policymaking process, the medium and long-term fiscal outlook of the federal government, and future tax rates is a concern for businesses, consumers and investors in the United States. In addition, economic conditions in foreign countries, including uncertainty over the stability of the euro currency, could affect the stability of global financial markets, which could hinder U.S. economic growth and affect our business and the businesses of our customers.

The Company’s operating market has begun to show demand for credit products as the continued low rate environment and expectations for economic expansion have increased refinancing as well as new loan activity. However, deterioration in economic conditions locally, regionally or nationally could result in an economic downturn in Northern California with the following consequences, any of which could adversely affect our business:

- loan delinquencies and defaults may increase;
- problem assets and foreclosures may increase;
- demand for loans and other products and services may decline;
- low cost or noninterest bearing deposits may decrease;
- collateral for loans may decline in value, in turn reducing clients’ borrowing power, and reducing the value of assets and collateral as sources of repayment of existing loans;
- foreclosed assets may not be able to be sold;
- volatile securities market conditions could adversely affect valuations of investment portfolio assets; and
- reputational risk may increase due to public sentiment regarding the banking industry.

- **Nonperforming assets take significant time to resolve and adversely affect our results of operations and financial condition.**

At December 31, 2018, our nonperforming loans and leases had decreased to 0.01% of total loans and leases. At December 31, 2018, our nonperforming assets (which include foreclosed real estate) to total assets had decreased to 0.14%. While these nonperforming loans and leases and nonperforming assets have decreased since 2008, there is no guarantee that these levels will continue into the future, which could adversely affect our results of operations, financial condition and stock price. A significant decline in our stock price could result in substantial losses for individual shareholders.

Nonperforming assets adversely affect our net income in various ways. We generally do not record interest income on nonperforming loans or other real estate owned, thereby adversely affecting our income and increasing our loan administration costs. When we take collateral in foreclosures and similar proceedings, we are required to mark the related asset to the then fair market value of the collateral, which may ultimately result in a loss. An increase in the level of nonperforming assets increases our risk profile and may impact the capital levels our regulators believe are appropriate in light of the ensuing risk profile, which could result in a request to reduce our level of nonperforming assets and/or raise additional capital. When we reduce problem assets through loan sales, workouts, restructurings and otherwise, decreases in the value of the underlying collateral, or in these borrowers’ performance or financial condition, whether or not due to economic and market conditions beyond our control, could adversely affect our business, results of operations and financial condition. In addition, the resolution of nonperforming assets requires significant commitments of time from management and our directors, which can be detrimental to the performance of their other responsibilities. We may experience increases in nonperforming assets and the disposition of such nonperforming assets may adversely affect our profitability.

- **Tightening of credit markets and liquidity risk could adversely affect our business, financial condition and results of operations.**

A tightening of the credit markets or any inability to obtain adequate funds for asset growth at an acceptable cost could adversely affect our asset growth and liquidity position and, therefore, our earnings capability. In addition to core deposit growth, maturity of investment securities and loan and lease payments, we also rely on alternative funding sources including unsecured borrowing lines with correspondent banks, secured borrowing lines with the Federal Home Loan Bank of San Francisco and the Federal Reserve Bank of San Francisco, and public time certificates of deposits. Our ability to access these sources could be impaired by deterioration in our financial condition as well as factors that are not specific to us, such as a disruption in the financial markets or negative views and expectations for the financial services industry or serious dislocation in the general credit markets. In the event such a disruption should occur, our ability to access these sources could be adversely affected, both as to price and availability, which would limit or potentially raise the cost of the funds available to us.

· **We have a concentration risk in real estate related loans.**

At December 31, 2018, $278.1 million, or 87.0% of our total loan and lease portfolio, consisted of real estate related loans. Of that amount, $199.9 million, or 71.9%, consisted of commercial real estate, $5.7 million, or 2.0% consisted of commercial and residential construction loans (including land acquisition and development loans) and $72.5 million, or 26.1%, consisted of residential mortgages and residential multi-family real estate. The majority of our real property collateral is located in our operating markets in Northern California. The deteriorating economic conditions in California and in our operating markets during the economic downturn of 2007 through 2010, contributed to an overall decline in commercial and residential real estate values. While property values have recovered somewhat, a substantial decline in commercial and residential real estate values in our primary operating markets could occur in the future as a result of any deterioration in economic conditions or other events including natural disasters such as earthquakes, droughts, floods, fires, and similar adverse weather occurrences. Such a decline in values could have an adverse impact on us by limiting repayment of defaulted loans through sale of commercial and residential real estate collateral and by a likely increase in the number of defaulted loans to the extent that the financial condition of our borrowers is adversely affected by such a decline in values.

· **We may take title to real estate that exposes us to the risk of environmental liabilities.**

Our loan and lease portfolio may include loans secured by real estate which could be subject to environmental liabilities. In the event that we foreclose upon and take title to such real estate, we may be held liable to a governmental entity or to third parties for property damage, personal injury, investigation and clean-up costs incurred by these parties in connection with environmental contamination, or we may be required to investigate or clean-up hazardous or toxic substances, or chemical releases at a property. The costs associated with investigation or remediation activities could be substantial. In addition, if we are the owner or former owner of a contaminated site, we may be subject to common law claims by third parties based on damages and costs resulting from environmental contamination emanating from the property. If we become subject to significant environmental liabilities, our business, financial condition, results of operations and cash flows could be materially adversely affected.

· **Our allowance for loan and lease losses may not be adequate to cover actual losses.**

Like all financial institutions, the Bank maintains an allowance for loan and lease losses to provide for loan defaults and nonperformance, but its allowance for loan and lease losses may not be adequate to cover actual loan and lease losses. In addition, future provisions for loan and lease losses could materially and adversely affect the Bank’s and therefore our Company’s operating results. The adequacy of the Bank’s allowance for loan and lease losses is based on prior experience, as well as an evaluation of the risks in the current portfolio. The amount of realizable future losses is susceptible to changes in economic, operating and other conditions, including changes in the local and general California real estate market and operating environment, as well as interest rates, employment levels and other economic factors that may be beyond our control, and these losses may exceed current estimates.

Federal regulatory agencies, as an integral part of the examination process, review the Bank’s loans and leases and allowance for loan and lease losses, as well as management’s policies and procedures for determining the adequacy of the allowance for loan and lease losses. We believe that our allowance for loan and lease losses policies are effective and that our allowance for loan and lease losses is adequate to cover current probable incurred losses. However, the Bank may have to further increase the allowance for loan and lease losses as a result of the effects of deterioration of economic conditions nationally and in the operating markets in which the Bank conducts business and/or as a result of changes in regulation or accounting methodologies.

· **Our focus on lending to small to mid-sized community-based businesses may increase our credit risk.**
As of December 31, 2018, our largest outstanding commercial business loan and largest outstanding commercial real estate loan amounted to $5.1 million and $7.4 million, respectively. At such date, our commercial real estate loans amounted to $199.9 million, or 61.9% of our total loan and lease portfolio, and our commercial business loans amounted to $29.7 million, or 9.2% of our total loan and lease portfolio. Commercial real estate and commercial business loans generally are considered riskier than single-family residential loans because they have larger balances to a single borrower or group of related borrowers. Commercial real estate and commercial business loans involve risks because the borrowers' ability to repay the loans typically depends primarily on the successful operation of the businesses or the properties securing the loans. Most of the Bank's commercial real estate and commercial business loans are made to small business or middle market customers who may have a heightened vulnerability to economic conditions. Moreover, a portion of these loans have been made by us in recent years and the borrowers may not have experienced a complete business or economic cycle. Furthermore, the deterioration of our borrowers' businesses may hinder their ability to repay their loans with us, which could adversely affect our results of operations.

· **Our business is subject to interest rate risk, and variations in interest rates may negatively affect our financial performance.**

Changes in the interest rate environment may reduce our net interest income. It is expected that we will continue to realize income from the differential or “margin” between the interest earned on loans, securities and other interest-earning assets, and interest paid on deposits, borrowings and other interest-bearing liabilities. Net interest margins are affected by the difference between the maturities and repricing characteristics of interest-earning assets and interest-bearing liabilities. In addition, loan volume and yields are affected by market interest rates on loans, and rising interest rates generally are associated with a lower volume of loan originations. We may be unable to minimize our interest rate risk. In addition, an increase in the general level of interest rates may adversely affect the ability of certain borrowers to pay the interest on and principal of their obligations. Accordingly, changes in levels of market interest rates could materially and adversely affect our net interest margin, asset quality, and loan origination volume.

· **Governmental fiscal and monetary policies may affect our business and are beyond our control.**

The business of banking is affected significantly by the fiscal and monetary policies of the federal government and its agencies. Such policies are beyond our control. We are particularly affected by the policies established by the Federal Reserve Board in relation to the supply of money and credit in the United States. The instruments of monetary policy available to the Federal Reserve Board can be used in varying degrees and combinations to directly affect the availability of bank loans and deposits, as well as the interest rates charged on loans and paid on deposits, and this can and does have a material effect on our business. The deterioration in economic conditions during the period of 2007 through 2010 resulted in government intervention and legislation intended to stabilize the U.S. financial system. Despite some improvement in economic conditions, the sustainability of the economic recovery is uncertain and a deterioration of economic conditions could result in further intervention and legislation beyond our control. Such deterioration could also limit our access to capital or sources of liquidity in amounts and at times necessary to conduct operations in compliance with applicable regulatory requirements.

· **The Bank faces strong competition from banks, financial service companies and other companies that offer banking services, which could adversely affect our business.**

Increased competition in our market areas may result in reduced loans and deposits or the rates charged or paid on these instruments and adversely affect our net interest margin. Ultimately, we may not be able to compete successfully against current and future competitors. Many competitors offer similar banking services compared to those that are offered by the Bank. These competitors include national and super-regional banks, finance companies, investment banking and brokerage firms, credit unions, government-assisted farm credit programs, other community banks and technology-oriented financial institutions offering online services. In particular, the Bank’s competitors include several major financial companies whose greater resources may afford them a marketplace advantage by enabling them to maintain numerous banking locations and mount extensive promotional and advertising campaigns. Additionally, banks and other financial institutions with larger capitalization and financial intermediaries not subject to bank regulatory restrictions have larger lending limits than we do and are thereby better able to serve the credit needs of larger customers. Areas of competition include interest rates for loans and deposits, efforts to obtain loans and deposits, as well as the range and quality of products and services provided, including new technology-driven products and services. Technological innovation continues to contribute to greater competition in domestic and international financial services markets as technological advances, such as Internet-based banking services that cross traditional geographic bounds, enable more companies to provide financial services. If the Bank is unable to attract and retain banking customers, we may be unable to maintain our historical levels of loans and leases and deposits or our net interest margin.

· **Our operations are dependent upon key personnel.**
Our future prospects are and will remain highly dependent on our directors, executive officers and other key personnel, including our Chief Executive Officer, our Chief Financial Officer and our Chief Credit Officer. From time to time, we have experienced changes in the membership of our board of directors and changes among the personnel serving as our executive officers. Our success will, to some extent, depend on the continued service of our directors and executive officers, in addition to our ability to continue to attract and retain experienced banking professionals to serve us and the Bank as directors, executive officers and in other key positions. The unexpected loss of the services of any of these individuals could have a detrimental effect on our business and future operations.

· **Technology implementation problems or computer system failures could adversely affect us.**
Our future growth prospects will be highly dependent on the ability of the Bank to implement changes in technology that affect the delivery of banking services such as the increased demand for computer access to bank accounts and the availability to perform banking transactions electronically. The Bank's ability to compete will depend upon its ability to continue to adapt technology on a timely and cost-effective basis to meet such demands. In addition, our business and operations and those of the Bank could be susceptible to adverse effects from computer failures, communication and energy disruption, and activities such as fraud of unethical individuals with the technological ability to cause disruptions or failures of the Bank's data processing system.

· **Cybersecurity breaches or other technological difficulties could adversely affect us.**
We cannot be certain that the continued implementation of safeguards will eliminate the risk of vulnerability to technological difficulties or failures or ensure the absence of a breach of information security, including as a result of cybersecurity breach. The FDIC cited cybersecurity as a critical challenge facing the financial services industry and stated that the frequency and sophistication of cyber-attacks are increasing. The Bank will continue to enhance its information security programs consistent with regulatory requirements including reliance on the services of various vendors who provide data processing and communication services to the financial services industry. Nonetheless, if information security is compromised or other technology difficulties or failures occur at the Bank or with one of our vendors, information may be lost or misappropriated, services and operations may be interrupted and the Bank could be exposed to claims from its customers as a result.

· **Our controls over financial reporting and related governance procedures may fail or be circumvented.**
Management regularly reviews and updates our internal control over financial reporting, disclosure controls and procedures, and corporate governance policies and procedures. We maintain controls and procedures to mitigate risks such as processing system failures or errors and customer or employee fraud, and we maintain insurance coverage for certain of these risks. Any system of controls and procedures, however well designed and operated, is based in part on certain assumptions and provides only reasonable, not absolute, certainty that the objectives of the system will be met. Events could occur which are not prevented or detected by our internal controls, are not insured against, or are in excess of our insurance limits. Any failure or circumvention of our controls and procedures, or failure to comply with regulations related to controls and procedures, could have an adverse effect on our business.

· **We may not be successful in raising additional capital needed in the future.**
If additional capital is needed in the future as a result of losses, our business strategy or regulatory requirements, our efforts to raise such additional capital may be unsuccessful or shares sold in the future may be sold at prices or on terms that are not equal to or better than the current market price. The inability to raise additional capital when needed or at prices and terms acceptable to us could adversely affect our ability to implement our business strategies.

· **The effects of legislation in response to credit conditions may adversely affect us.**

Legislation that has or may be passed at the federal level and/or by the State of California in response to conditions affecting credit markets could cause us to experience higher credit losses if such legislation reduces the amount that the Bank's borrowers are otherwise contractually required to pay under existing loan contracts. Such legislation could also result in the imposition of limitations upon the Bank's ability to foreclose on property or other collateral or make foreclosure less economically feasible. Such events could result in increased loan and lease losses and require a material increase in the allowance for loan and lease losses.

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- **The effects of changes to FDIC insurance coverage limits and assessments are uncertain and increased premiums may adversely affect us.**

FDIC insurance premium assessments are uncertain and increased premium assessments may adversely affect our earnings. The FDIC charges insured financial institutions premiums to maintain the Deposit Insurance Fund (the "DIF"). Bank failures increased significantly during the economic downturn causing the FDIC to take control of failed institutions and guarantee payment from the DIF up to the insured limit for deposits held at such failed institutions. The sustainability of the economic recovery is uncertain and a deterioration of economic conditions may cause losses which require premium increases to replenish the DIF.

On November 9, 2010, the FDIC issued a final rule implementing section 343 of the Dodd-Frank Act that made permanent a $250,000 deposit insurance limit per depositor. In addition, the Dodd-Frank Act also made other deposit insurance changes which may affect our insurance premium assessments to include (i) amendment of the assessment base used to calculate an insured depository institution's deposit insurance premiums paid to the DIF by elimination of deposits and substitution of average consolidated total assets less average tangible equity during the assessment period as the revised assessment base; (ii) increasing the minimum designated reserve ratio of the DIF; (iii) eliminating the requirement that the FDIC pay dividends to depository institutions when the reserve ratio exceeds certain thresholds; and (iv) repeal of the prohibition upon the payment of interest on demand deposits to be effective one year after the date of enactment of the Dodd-Frank Act.

On November 18, 2014, the FDIC adopted the Assessments Final Rule which revises the FDIC's risk-based deposit insurance assessment system to reflect changes in the regulatory capital rules that were effective commencing January 1, 2015. For smaller financial institutions such as the Bank (with total assets less than $1 billion and which are not custodial banks), the Final Rule revises and conforms capital ratios and ratio thresholds to the new prompt corrective action capital ratios and ratio thresholds for "well capitalized" and "adequately capitalized" evaluations which were adopted by the federal banking agencies as part of the so-called Basel III capital regulations.

Although American River Bank's recent assessments have declined as a result of the change to the deposit assessment system, it is uncertain what effect the implementation of the changes to the insurance assessments will have upon the Company's costs of operations in the future, but a deterioration in the economic conditions impacting financial institutions or a significant number of failed institutions might necessitate increases in premium assessments to maintain the DIF which could adversely impact the Company's earnings.

- **In the future we may be required to recognize impairment with respect to investment securities, including the FHLB stock we hold.**

Our securities portfolio currently includes securities with unrecognized losses. We may continue to observe declines in the fair market value of these securities. We evaluate the securities portfolio for any other than temporary impairment each reporting period, as required by generally accepted accounting principles, and as of December 31, 2018, we did not recognize any securities as other than temporarily impaired. Future evaluations of the securities portfolio may require us to recognize an impairment charge with respect to these and other holdings. In addition, as a condition to membership in the Federal Home Loan Bank of San Francisco (the "FHLB"), we are required to purchase and hold a certain amount of FHLB stock. Our stock purchase requirement is based, in part, upon the outstanding principal balance of advances from the FHLB. At December 31, 2018, we held stock in the FHLB totaling $3.9 million. The FHLB stock held by us is carried at cost and is subject to recoverability testing under applicable accounting standards. The FHLB currently distributes cash dividends on its shares, however, past dividend paying practices are not a guarantee of future dividends. To date, we have not recognized any impairment charges related to our FHLB stock holdings. Any future negative changes to the financial condition of the FHLB may require us to recognize an impairment charge with respect to such holdings.

- **If our enterprise risk management framework is not effective at mitigating risk and loss to us, we could suffer unexpected losses and our results of operations could be materially adversely affected**.

Our enterprise risk management framework seeks to achieve an appropriate balance between risk and return, which is critical to optimizing shareholder value. We have established processes and procedures intended to identify, measure, monitor, report and analyze the types of risk to which we are subject, including credit, liquidity, operational, regulatory compliance and reputational. However, as with any risk management framework, there are inherent limitations to our risk management strategies as there may exist, or develop in the future, risks that we have not appropriately anticipated or identified. If our risk management framework proves ineffective, we could suffer unexpected losses and our business and results of operations could be materially adversely affected.

- **Our modest size makes it more difficult for us to compete.**

Our modest size makes it more difficult to compete with other financial institutions which are generally larger and can more easily afford to invest in the marketing and technologies needed to attract and retain customers. Because our principal source of income is the net interest income we earn on our loans and investments after deducting interest paid on deposits and other sources of funds, our ability to generate the revenues needed to cover our expenses and finance such investments is limited by the size of our loan and investment portfolios. Accordingly, we are not always able to offer new products and services as quickly as our competitors. As a smaller institution, we are also disproportionately affected by the continually increasing costs of compliance with new banking and other regulations.

- **We face risks related to our operational, technological and organizational infrastructure.**

Our ability to grow and compete is dependent on our ability to build or acquire the necessary operational and technological infrastructure and to manage the cost of that infrastructure as we expand. Similar to other corporations, operational risk can manifest itself in many ways, such as errors related to failed or inadequate processes, faulty or disabled computer systems, fraud by employees or outside persons and exposure to external events. As discussed below, we are dependent on our operational infrastructure to help manage these risks. In addition, we are heavily dependent on the strength and capability of our technology systems which we use both to interface with our customers and to manage our internal financial records and other systems. Our ability to develop and deliver new products that meet the needs of our existing customers and attract new ones depends on the functionality of our technology systems. Additionally, our ability to run our business in compliance with applicable laws and regulations is dependent on these infrastructures.

We monitor our operational and technological capabilities and make modifications and improvements when we believe it will be cost effective to do so. In some instances, we may build and maintain these capabilities ourselves. Specifically, we provide our own core systems processing and essential web hosting. We also outsource some of these functions to third parties. If we experience difficulties, fail to comply with banking regulations or keep up with increasingly sophisticated technologies, our operations could be interrupted. If an interruption were to continue for a significant period of time, our business, financial condition and results of operations could be adversely affected, perhaps materially. Even if we are able to replace them, it may be at a higher cost to us, which could materially adversely affect our business, financial condition and results of operations.

- **Adherence to our internal policies and procedures by our employees is critical to our performance and how we are perceived by our regulators.**

Our internal policies and procedures are a critical component of our corporate governance and, in some cases, compliance with applicable regulations. We adopt internal policies and procedures to guide management and employees regarding the operation and conduct of our business. Any deviation or non-adherence to these internal policies and procedures, whether intentional or unintentional, could have a detrimental effect on our management, operations or financial condition.

- **We must keep pace with technological change to remain competitive and introduce new products and services.**

Financial products and services have become increasingly technologically driven. Our ability to meet the needs of our customers competitively and introduce new products in a cost-efficient manner is dependent on the ability to keep pace with technological advances, to invest in new technology as it becomes available, and to obtain and maintain related essential personnel. Many of our competitors have already implemented critical technologies and have greater resources to invest in technology than we do and may be better equipped to market new technologically driven products and services. In addition, we may not have the same ability to rapidly respond to technological innovations as our competitors do. Furthermore, the introduction of new technologies and products by financial technology companies and “fintech” platforms may adversely affect our ability to obtain new customers and successfully grow our business. The ability to keep pace with technological change is important, and the failure to do so, due to cost, proficiency or otherwise, could have a material adverse impact on our business and therefore on our financial condition and results of operations.

- **Changes in accounting standards could materially impact our financial statements.**

From time to time, the Financial Accounting Standards Board or the SEC may change the financial accounting and reporting standards that govern the preparation of our financial statements. Such changes may result in us being subject to new or changing accounting and reporting standards. In addition, the bodies that interpret the accounting standards (such as banking regulators, outside auditors or management) may change their interpretations or positions on how these standards should be applied. These changes may be beyond our control, can be hard to predict, and can materially impact how we record and report our financial condition and results of operations. In some cases, we could be required to apply a new or revised standard retrospectively, or apply an existing standard differently, also retrospectively, in each case resulting in our needing to revise or restate prior period financial statements.

- **If the goodwill we have recorded in connection with our acquisition of Bank of Amador becomes impaired, it could have an adverse impact on our earnings and capital.**

At December 31, 2018, we had approximately $16.3 million of goodwill on our balance sheet attributable to our merger with Bank of Amador in December 2004. In accordance with accounting principles generally accepted in the United States of America, our goodwill is not amortized but rather evaluated for impairment on an annual basis or more frequently if events or circumstances indicate that a potential impairment exists. Such evaluation is based on a variety of factors, including the quoted price of our common stock, market prices of the common stock of other banking organizations, common stock trading multiples, discounted cash flows, and data from comparable acquisitions. Future evaluations of goodwill may result in findings of impairment and write-downs, which could be material.

- **We face a risk of noncompliance and enforcement action with the Bank Secrecy Act and other anti-money laundering statutes and regulations.**

The Bank Secrecy Act, the Patriot Act and other laws and regulations require financial institutions, among other duties, to institute and maintain an effective anti-money laundering program and to file timely reports such as suspicious activity reports and currency transaction reports. We are required to comply with these and other anti-money laundering requirements. The federal banking agencies and Financial Crimes Enforcement Network are authorized to impose significant civil money penalties for violations of those requirements and have recently engaged in coordinated enforcement efforts against banks and other financial services providers with the U.S. Department of Justice, Drug Enforcement Administration and Internal Revenue Service. If our policies, procedures and systems are deemed deficient, we would be subject to liability, including fines and regulatory actions, which may include restrictions on our ability to pay dividends and the necessity to obtain regulatory approvals to proceed with certain aspects of our business plan.

Failure to maintain and implement adequate programs to combat money laundering and terrorist financing could also have serious reputational consequences for us. Any of these results could have a material adverse effect on our business, financial condition, results of operations and growth prospects.

- **We are subject to the CRA and fair lending laws, and failure to comply with these laws could lead to material penalties.**

The CRA, the Equal Credit Opportunity Act, the Fair Housing Act and other fair lending laws and regulations impose nondiscriminatory lending requirements on financial institutions. The Consumer Financial Protection Bureau, the United States Department of Justice and other federal agencies are responsible for enforcing these laws and regulations. A successful challenge to an institution's performance under the CRA or fair lending laws and regulations could result in a wide variety of sanctions, including the required payment of damages and civil money penalties, injunctive relief, imposition of restrictions on mergers and acquisitions activity and restrictions on expansion activity. Private parties may also have the ability to challenge an institution's performance under fair lending laws in private class action litigation.

- **Federal regulators periodically examine our business, and we may be required to remediate adverse examination findings.**

The FDIC and DBO periodically examine our business, including our compliance with laws and regulations. If, as a result of an examination, a federal banking agency were to determine that our financial condition, capital resources, asset quality, earnings prospects, management, interest rate risk and liquidity or other aspects of any of our operations had become unsatisfactory, or that we were in violation of any law or regulation, it may take a number of different remedial actions as it deems appropriate. These actions include the power to enjoin "unsafe or unsound" practices, to require affirmative action to correct any conditions resulting from any violation or practice, to issue an administrative order that can be judicially enforced, to direct an increase in our capital, to restrict our growth, to assess civil monetary penalties against our officers or directors, to remove officers and directors and, if it is concluded that such conditions cannot be corrected or there is an imminent risk of loss to depositors, to terminate our deposit insurance and place us into receivership or conservatorship. If we become subject to any regulatory actions, including memorandums of understanding or cease and desist orders, it could have a material adverse effect on our business, results of operations, financial condition and growth prospects.

- **As a result of the Dodd-Frank Act and recent rulemaking, we are subject to more stringent capital requirements.**

In July 2013, the U.S. federal banking authorities approved new regulatory capital rules implementing the Basel III regulatory capital reforms effecting certain changes required by the Dodd-Frank Act. The new regulatory capital rules not only increase most of the required minimum regulatory capital ratios, but also introduce a new common equity Tier 1 capital ratio and the concept of a capital conservation buffer. The new regulatory capital rules also expand the current definition of capital by establishing additional criteria that capital instruments must meet to be considered additional Tier 1 and Tier 2 capital. In order to be a "well capitalized" depository institution under the new regime, an institution must maintain a common equity Tier 1 capital ratio of 6.5% or more; a Tier 1 capital ratio of 8% or more; a total capital ratio of 10% or more; and a leverage ratio of 5% or more. Institutions must also maintain a capital conservation buffer consisting of common equity Tier 1 capital. The regulatory capital rules became effective as applied to American River Bank on January 1, 2015 with a phase-in period that generally extends through January 1, 2019 for many of the changes. The failure to meet applicable regulatory capital requirements could result in one or more of our regulators placing limitations or conditions on our activities, including our growth initiatives, or restricting the commencement of new activities, and could materially adversely affect customer and investor confidence, our costs of funds and FDIC insurance costs, our ability to pay dividends on our common stock, our ability to make acquisitions, and our business, results of operations and financial conditions, generally.

- **The FASB has recently issued an accounting standard update that will result in a significant change in how we provide for credit losses and may have a material impact on our financial condition or results of operations.**

In June 2016, the Financial Accounting Standards Board ("FASB") issued an accounting standard update, "Financial Instruments-Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments," which replaces the current "incurred loss" model for recognizing credit losses with an "expected loss" model referred to as the Current Expected Credit Loss ("CECL") model. Under the CECL model, we will be required to present certain financial assets carried at amortized cost, such as loans held for investment and held-to-maturity debt securities, at the net amount expected to be collected. The measurement of expected credit losses is to be based on information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. This measurement will take place at the time the financial asset is first added to the balance sheet and periodically thereafter. This differs significantly from the "incurred loss" model required under

GAAP, which delays recognition until it is probable a loss has been incurred. Accordingly, we expect that the adoption of the CECL model will materially affect how we determine our allowance for loan losses and could require us to significantly increase our allowance. Moreover, the CECL model may create more volatility in the level of our allowance for loan losses. If we are required to materially increase our level of allowance for loan and lease losses for any reason, such increase could adversely affect our business, financial condition and results of operations.

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The new CECL standard will become effective for us for the fiscal year beginning January 1, 2020 and for interim periods thereafter. We are currently evaluating the impact the CECL model will have on our accounting, but we expect to recognize a one-time cumulative-effect adjustment to our allowance for loan and lease losses as of the beginning of the first reporting period in which the new standard is effective, consistent with regulatory expectations set forth in interagency guidance issued at the end of 2016. The one-time cumulative effect adjustment to allowance for loan and lease losses will be offset by a charge to retained earnings and therefore reduce equity capital. We have not yet determine the magnitude of any such one-time cumulative adjustment or of the overall impact of the new standard on our financial condition or results of operations.

- **The effects of terrorism and other events beyond our control, including natural disasters, may adversely affect our customers and our results of operations.**

The terrorist actions on September 11, 2001 and thereafter, as well as the military conflicts in the Middle East, have had significant adverse effects upon the United States economy. Whether terrorist activities in the future and the actions of the United States and its allies in combating terrorism on a worldwide basis will adversely impact us and the extent of such impact is uncertain. Similar events beyond our control including, but not limited to, financial and economic instability and governmental actions in response, natural disasters such as earthquakes, droughts, floods, fires, and similar adverse weather occurrences, disruption of power and energy supplies and communications equipment such as telephones, cellular phones, computers, and other forms of electronic equipment or media, and widespread, adverse public health occurrences, may adversely affect our future results of operations by, among other things, disrupting the conduct of our operations and those of our customers, which could result in a reduction in the demand for loans and other products and services offered by the Bank, increase nonperforming loans and the amounts reserved for loan and lease losses, or cause significant declines in our level of deposits.

- **Future acquisitions and expansion activities may disrupt our business and adversely affect our operating results.**

We periodically evaluate potential acquisitions and expansion opportunities. To the extent that we grow through acquisitions, we cannot ensure that we will be able to adequately or profitably manage this growth. Acquiring other banks, branches or other assets, as well as other expansion activities, involves various risks including the risks of incorrectly assessing the credit quality of acquired assets, encountering greater than expected costs of incorporating acquired banks or branches into the Bank, executing cost savings measures, and being unable to profitably deploy funds in an acquisition.

- **We may raise additional capital, which could have a dilutive effect on the existing holders of our common stock and adversely affect the market price of our common stock.**

Our articles of incorporation, as amended, provide the authority to issue without further shareholder approval, 20,000,000 shares of common stock, no par value per share, of which 5,858,428 shares were issued and outstanding at December 31, 2018. Pursuant to the Company’s 2010 Equity Incentive Plan and its 2000 Stock Option Plan, at December 31, 2018, employees and directors of the Company had outstanding options to purchase 41,098 shares of common stock. As of December 31, 2018, 1,287,096 shares of common stock remained available for awards under the 2010 Equity Incentive Plan.

We are not restricted from issuing additional shares of common stock or securities that are convertible into or exchangeable for, or that represent the right to receive, common stock. We frequently evaluate opportunities to access the capital markets taking into account our regulatory capital ratios, financial condition and other relevant considerations, and subject to market conditions, we may take further capital actions. Such actions could include, among other things, the issuance of additional shares of common stock in public or private transactions in order to further increase our capital levels above the requirements for a well capitalized institution established by the federal bank regulatory agencies as well as other regulatory targets.

The issuance of any additional shares of common stock or securities convertible into or exchangeable for common stock or that represent the right to receive common stock, or the exercise of such securities including, without limitation, securities issued upon exercise of outstanding equity awards under our 2010 Equity Incentive Plan or outstanding options under our 2000 Stock Option Plan, could be substantially dilutive to shareholders of our common stock. Holders of our shares of common stock have no preemptive rights that entitle holders to purchase their pro rata share of any offering of shares of any class or series and, therefore, such sales or offerings could result in increased dilution to our shareholders. The market price of our common stock could decline as a result of sales of shares of our common stock or the perception that such sales could occur.

- **Our common stock is subordinate to our existing and future indebtedness and preferred stock.**

Shares of our common stock are equity interests and do not constitute indebtedness. As such, our common stock ranks junior to all our customer deposits and indebtedness, whether now existing or hereafter incurred, and other non-equity claims on us, with respect to assets available to satisfy claims. Additionally, holders of common stock are subject to the prior liquidation rights of the holders of any debt we may issue in the future and may be subject to the prior dividend and liquidation rights of any series of preferred stock we may issue in the future.

- **The price of our common stock may fluctuate significantly, and this may make it difficult for shareholders to resell shares of common stock they own at times or at prices they find attractive.**

The stock market and, in particular, the market for financial institution stocks, has experienced significant volatility. In some cases, the markets have produced downward pressure on stock prices for certain issuers without regard to those issuers' underlying financial strength. As a result, the trading volume in our common stock may fluctuate more than usual and cause significant price variations to occur. This may make it difficult for shareholders to resell shares of common stock they own at times or at prices they find attractive. The low trading volume in our common shares on the NASDAQ Global Select Market means that our shares may have less liquidity than other publicly traded companies. We cannot ensure that the volume of trading in our common shares will be maintained or will increase in the future.

The trading price of the shares of our common stock will depend on many factors, which may change from time to time and which may be beyond our control, including, without limitation, our financial condition, performance, creditworthiness and prospects, future sales or offerings of our equity or equity related securities, and other factors identified above in the forward-looking statement discussion in Part I, Item 1 of this Annual Report on Form 10-K under the heading "Cautionary Statements Regarding Forward-Looking Statements" and below. These broad market fluctuations have adversely affected and may continue to adversely affect the market price of our common stock. Among the factors that could affect our stock price are:

- actual or anticipated quarterly fluctuations in our operating results and financial condition;
- changes in financial estimates or publication of research reports and recommendations by financial analysts or actions taken by rating agencies with respect to our common stock or those of other financial institutions;
- failure to meet analysts' revenue or earnings estimates;
- speculation in the press or investment community generally or relating to our reputation, our market area, our competitors or the financial services industry in general;
- strategic actions by us or our competitors, such as acquisitions, restructurings, dispositions or financings;
- actions by our current shareholders, including sales of common stock by existing shareholders and/or directors and executive officers;
- fluctuations in the stock price and operating results of our competitors;
- future sales of our equity, equity-related or debt securities;
- changes in the frequency or amount of dividends or share repurchases;
- proposed or adopted regulatory changes or developments;

- anticipated or pending investigations, proceedings, or litigation that involves or affects us;
- trading activities in our common stock, including short-selling;
- domestic and international economic factors unrelated to our performance; and
- general U.S. and international market conditions and, in particular, developments related to market conditions for the financial services industry.

A significant decline in our stock price could result in substantial losses for our shareholders.

- **We may be unable or choose not to pay cash dividends in the foreseeable future.**

Our ability to pay dividends on our common stock depends on a variety of factors. The Company relies on distributions from the Bank in the form of cash dividends in order to pay cash dividends to our shareholders. Cash dividends may or may not be paid in the future since they are subject to regulatory restrictions and to evaluation by our Board of Directors of financial factors including, but not limited to, our earnings, financial condition and capital requirements.

- **Anti-takeover provisions in our articles of incorporation and bylaws and California law could make a third party acquisition of us difficult.**

Our articles of incorporation and bylaws contain provisions that could make it more difficult for a third party to acquire us (even if doing so would be beneficial to our shareholders) and for holders of our common stock to receive any related takeover premium for their common stock, including advance notice procedures for shareholder proposals and the authorization of 10,000,000 shares of blank-check preferred stock. We are also subject to certain provisions of California law and federal law that would delay, deter or prevent a change in control of the Company. These provisions could limit the price that investors might be willing to pay in the future for shares of our common stock.

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

The Company and American River Bank lease nine and own two of their respective premises. The Company’s headquarters office is located at 3100 Zinfandel Drive, Suite 450, Rancho Cordova, California. The office space is located in a six-story office building. The seven (7) year lease term was set to expire on July 31, 2017 but was renewed in 2016 for an additional seventy-nine (79) months to expire on December 31, 2022. The premises consist of approximately 12,218 square feet on the fourth floor of the building. The space is leased from Ethan Conrad Properties, Inc., successor to MSCP Capital Center Investors, LLC PGOCC, LLC, and One Capital Center.

American River Bank’s main office is located at 1545 River Park Drive, Suite 107, Sacramento, California, in a modern, five-story building which has off-street parking for its clients. American River Bank leases premises in the building from Hines VAF II Sacramento Properties, L.P., the successor to Spieker Properties. The lease term is for one-hundred and twenty-seven (127) months and expires on February 28, 2021. The premises consist of 1,643 square feet on the ground floor.

American River Bank leases premises at 9750 Business Park Drive, Sacramento, California. The premises are leased from Bradshaw Plaza, Associates, Inc., which is owned in part by Charles D. Fite, a director of the Company. The lease term is three (3) years and expires on November 30, 2019. The premises consist of 3,711 square feet on the ground floor.

American River Bank leases premises at 11220 Gold River Express Drive, Gold River, California. The premises are leased from Gold River Village Associates, a California Limited Partnership. The lease term is one-hundred and twenty-six (126) months and expires on November 30, 2024. The premises consist of 1,650 square feet on the ground floor.

American River Bank leases premises at 2150 Douglas Boulevard, Roseville, California. The premises are leased from DDS Properties, a California General Partnership. The lease term is one hundred and twenty-six (126) months and expires on May 31, 2027. The premises consist of 2,269 square feet on the ground floor.

American River Bank leases premises at 520 Capitol Mall, Sacramento, California. The premises are leased from 520 Capitol Mall, Inc. The lease term is one-hundred and twenty-five (125) months and expires on October 31, 2024. The premises consist of 2,143 square feet on the second floor.

American River Bank owns premises at 412 Center Street, Healdsburg, California. The premises were purchased June 1, 1993. The purchase price for the land and building was $343,849. The building consists of 2,620 square feet. The land consists of 10,835 square feet.

American River Bank leases premises at 90 South E Street, Santa Rosa, California. The premises were subleased from Chicago Title Company through November 11, 2011 and then leased from 90 E Street, LLC until 90 E. Street SR, LLC purchased the building. The initial combined sublease and lease term is ten (10) years and expires on January 31, 2019. In September of 2018, the lease was amended and extended for another ten (10) year term and now expires on January 31, 2029. The premises consist of 3,600 square feet on the ground floor.

American River Bank leases premises at 422 Sutter Street, Jackson, California. The premises are leased from the United States Postal Service. The lease term is five (5) year and expires on May 31, 2022 and the premises consisted of 3,600 square feet on the ground floor.

American River Bank leases premises at 26395 Buckhorn Ridge Road, Pioneer, California. The premises are leased from Joseph T. Bellamy, Trustee of the Joseph T. Bellamy 2005 Trust. The lease term is five (5) years and expires on October 31, 2022. The premises consist of 1,757 square feet of office space on the ground floor, an attached garage consisting of approximately 400 square feet and 1,223 feet of office space on the second floor.

American River Bank, owns premises at 66 Main Street, Ione, California. The premises were purchased April 1, 1995. The purchase price for the land and building was $167,500. The building consists of 2,576 square feet. The land consists of 9,700 square feet.

The leases on the premises located at 1545 River Park Drive, 2150 Douglas Boulevard, 90 South E Street, 11220 Gold River Express Drive, 520 Capitol Mall, 422 Sutter Street, and 3100 Zinfandel Drive, contain options to extend for five years. Included in the above premises is a facility leased from a current director of the Company at terms and conditions which management believes are consistent with the commercial lease market. The foregoing summary descriptions of leased premises are qualified in their entirety by reference to the lease agreements listed as exhibits in Part IV, Item 15 of this Annual Report on Form 10-K.

Item 3. Legal Proceedings.

There are no material legal proceedings adverse to the Company and its subsidiaries to which any director, officer, affiliate of the Company, or 5% shareholder of the Company or its subsidiaries, or any associate of any such director, officer, affiliate or 5% shareholder of the Company or its subsidiaries are a party, and none of the above persons has a material interest adverse to the Company or its subsidiaries.

From time to time, the Company and/or its subsidiaries may be a party to claims and legal proceedings arising in the ordinary course of business. The Company’s management is not aware of any pending legal proceedings to which either it or its subsidiaries may be a party or has recently been a party, which will have a material adverse effect on the financial condition or results of operations of the Company or its subsidiaries.

Item 4. Mine Safety Disclosures.

Not applicable.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Market Information

The Company's common stock began trading on the NASDAQ National Stock Market ("Nasdaq") under the symbol "AMRB" on October 26, 2000. Effective July 3, 2006, the Company's common stock became listed and traded on the Nasdaq Global Select Market. The closing price for the Company's common stock on February 20, 2019 was $14.05.

Holders

As of February 7, 2019, there were approximately 2,446 shareholders of record of the Company's common stock.

Dividends

The Company paid quarterly cash dividends on its common stock from the first quarter of 2004 through the second quarter of 2009. Prior to that, the Company paid cash dividends twice a year since 1992. On July 27, 2009, the Company announced that the Board of Directors had suspended the payment of cash dividends, until such time that it was prudent to reestablish the payment of cash dividends. On January 25, 2017, the Board reinstated the quarterly cash dividend and in each of 2018 and 2017 the Company paid four cash dividends per year in the aggregate amount of $0.20 per common share. The Company relies on distributions from the Bank in the form of cash dividends in order to pay cash dividends to our shareholders. We cannot provide any assurance as to whether any dividends will continue to be paid in the future since they are subject to regulatory and statutory restrictions and the evaluation by the Company's Board of Directors of financial factors including, but not limited to earnings, financial condition and capital requirements of the Company and its subsidiaries.

As a California corporation, the Company's ability to pay cash dividends is subject to restrictions set forth in the California General Corporation Law (the "Corporation Law"). The Corporation Law provides that neither a corporation nor any of its subsidiaries shall make a distribution to the corporation's shareholders unless the board of directors has determined in good faith either of the following: (1) the amount of retained earnings of the corporation immediately prior to the distribution equals or exceeds the sum of (A) the amount of the proposed distribution plus (B) the preferential dividends arrears amount; or (2) immediately after the distribution, the value of the corporation's assets would equal or exceed the sum of its total liabilities plus the preferential rights amount. The good faith determination of the board of directors may be based upon (1) financial statements prepared on the basis of reasonable accounting practices and principles, (2) a fair valuation, or (3) any other method reasonable under the circumstances; provided, that a distribution may not be made if the corporation or subsidiary making the distribution is, or is likely to be, unable to meet its liabilities (except those whose payment is otherwise adequately provided for) as they mature.

The Board of Governors generally prohibits a bank holding company from declaring or paying a cash dividend which would impose undue pressure on the capital of subsidiary banks or would be funded only through borrowing or other arrangements that might adversely affect a bank holding company's financial position. The Board of Governors' policy is that a bank holding company should not continue its existing rate of cash dividends on its common stock unless its net income is sufficient to fully fund each dividend and its prospective rate of earnings retention appears consistent with its capital needs, asset quality and overall financial condition.

The payment of cash dividends by American River Bank is subject to restrictions set forth in the California Financial Code (the "Financial Code"). The Financial Code provides that a bank may not make a cash distribution to its shareholders in excess of the lesser of (a) the bank's retained earnings; or (b) the bank's net income for its last three fiscal years, less the amount of any distributions made by the bank or by any majority-owned subsidiary of the bank to the shareholders of the bank during such period. However, a bank may, with the approval of the Commissioner, make a distribution to its shareholders in an amount not exceeding the greater of (a) its retained earnings; (b) its net income for its last fiscal year; or (c) its net income for its current fiscal year. In the event that the Commissioner determines that the shareholders' equity of a bank is inadequate or that the making of a distribution by the bank would be unsafe or unsound, the Commissioner may order the bank to refrain from making a proposed distribution.

The FDIC may also restrict the payment of dividends by a subsidiary bank if such payment would be deemed unsafe or unsound or if after the payment of such dividends, the bank would be included in one of the "undercapitalized" categories for capital adequacy purposes pursuant to the FDIC Improvement Act of 1991.

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Stock Repurchases

On January 24, 2018, the Company approved and authorized a stock repurchase program for 2018 (the “2018 Program”). The 2018 Program authorized the repurchase during 2018 of up to 5% of the outstanding shares of the Company’s common stock, or approximately 306,618 shares based on the 6,132,362 shares outstanding as of December 31, 2017. During 2018, the Company repurchased 308,618 shares of its common stock at an average price of $15.52 per share. Repurchases under the 2018 Program were made from time to time by the Company in the open market. All such transactions were structured to comply with Securities and Exchange Commission Rule 10b-18 and all shares repurchased under the 2018 Program were retired.

The following table lists shares repurchased during the quarter ended December 31, 2018 and the maximum amount available to repurchase under the repurchase plan.

Period	(a) Total Number of Shares (or Units) Purchased	(b) Average Price Paid Per Share (or Unit)	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) That May Yet Be Purchased Under the Plans or Programs
Month #1 October 1 through October 31, 2018	—	—	—	7,840
Month #2 November 1 through November 30, 2018	7,840	15.07	7,840	—
Month #3 December 1 through December 31, 2018	—	—	—	—
Total	7,840	15.07	7,840	—

The Company repurchased 574,748 shares in 2017, 716,897 shares in 2016, 790,989 shares in 2015, and 424,462 shares in 2014. Share amounts have been adjusted for stock dividends and/or splits.

Item 6. Selected Financial Data.

FINANCIAL SUMMARY-The following table presents certain consolidated financial information concerning the business of the Company and its subsidiaries. This information should be read in conjunction with the Consolidated Financial Statements, the notes thereto, and Management’s Discussion and Analysis included in this report. All per share data has been retroactively restated to reflect stock dividends and stock splits.

As of and for the Years Ended December 31,

(In thousands, except per share amounts and ratios)

	2018	2017	2016	2015	2014
Operations Data:					
Net interest income	$20,646	$19,353	$20,243	$20,007	$18,797
Provision for loan and lease losses	175	450	(1,344)	—	(541)
Noninterest income	1,513	1,596	2,045	2,015	2,177
Noninterest expenses	15,510	14,049	13,836	14,080	14,862
Income before income taxes	6,474	6,450	9,796	7,942	6,653
Income tax expense	1,574	3,252	3,392	2,674	2,292
Net income	$4,900	$3,198	$6,404	$5,268	$4,361
Share Data:					
Earnings per share – basic	$0.83	$0.50	$0.95	$0.70	$0.54
Earnings per share – diluted	$0.83	$0.50	$0.94	$0.70	$0.54
Cash dividends per share (1)	$0.20	$0.20	$0.00	$0.00	$0.00
Book value per share	$12.75	$12.54	$12.59	$11.72	$11.08
Tangible book value per share	$9.97	$9.88	$10.14	$9.50	$9.06
Balance Sheet Data:					
Assets	$688,092	$655,622	$651,450	$634,640	$617,754
Loans and leases, net	318,516	308,713	324,086	289,102	258,057
Deposits	590,674	556,080	544,806	530,690	510,693
Shareholders’ equity	74,721	76,921	83,850	86,075	89,647
Financial Ratios:					
Return on average equity	6.77%	3.91%	7.60%	6.03%	4.98%
Return on average tangible equity	8.74%	4.88%	9.43%	7.42%	6.12%
Return on average assets	0.72%	0.49%	1.00%	0.85%	0.72%
Efficiency ratio (2)	69.35%	65.84%	60.81%	62.87%	69.96%
Net interest margin (2) (3)	3.41%	3.39%	3.62%	3.63%	3.54%
Net loans and leases to deposits	53.92%	55.52%	59.49%	54.48%	50.53%
Net charge-offs (recoveries) to average loans & leases	0.08%	0.25%	(0.39%)	0.12%	(0.20%)
Nonperforming loans and leases to total loans and leases (4)	0.01%	0.60%	0.01%	0.56%	0.63%
Allowance for loan and lease losses to total loans and leases	1.36%	1.43%	1.47%	1.69%	2.01%
Average equity to average assets	10.62%	12.53%	13.20%	14.02%	14.47%

Dividend payout ratio (1)	24	%	40	%	0	%	0	%	0	%
Capital Ratios:										
Leverage capital ratio	8.94	%	9.45	%	10.50	%	10.97	%	11.60	%
Tier 1 risk-based capital ratio	16.11	%	18.08	%	19.02	%	19.34	%	21.60	%
Total risk-based capital ratio	17.29	%	19.34	%	20.27	%	20.59	%	22.85	%

(1) On January 25, 2017, the Company reinstated the payment of quarterly cash dividends.
(2) Fully taxable equivalent.
(3) Excludes the amortization of intangible assets.
(4) Nonperforming loans and leases consist of loans and leases past due 90 days or more and still accruing and nonaccrual loans and leases.

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

This discussion should be read in conjunction with “Item 1. Business-Cautionary Statements Regarding Forward-Looking Statements,” “Item 1A. Risk Factors,” and “Item 8. Financial Statements and Supplementary Data” of this report.

Use of Non-GAAP Financial Measures

This Annual Report on Form 10-K (“Form 10K”) contains certain non-GAAP (Generally Accepted Accounting Principles) financial measures in addition to results presented in accordance with GAAP. These measures include tangible book value and taxable equivalent basis. Management has presented these non-GAAP financial measures in this Form 10K because it believes that they provide useful and comparative information to assess trends in the Company’s financial position reflected in the results and facilitate comparison of our performance with the performance of our peers.

Net Interest Margin and Efficiency Ratio (non-GAAP financial measures)

In accordance with industry standards, certain designated net interest income amounts are presented on a

taxable equivalent basis, including the calculation of net interest margin and the efficiency ratio. The Company believes the presentation of net interest margin on a taxable equivalent basis using a 21% effective tax rate for 2018 and 34% effective tax rate for 2017 and 2016 allows comparability of net interest margin with industry peers by eliminating the effect of the differences in portfolios attributable to the proportion represented by both taxable and tax-exempt loans and investments. The efficiency ratio is a measure of a banking company’s overhead as a percentage of its revenue. The Company derives this ratio Sby dividing total noninterest expense by the sum of the taxable equivalent net interest income and the total noninterest income.

Tangible Equity (non-GAAP financial measures)

Tangible common stockholders’ equity (tangible book value) excludes goodwill and other intangible assets. The Company believes the exclusion of goodwill and other intangible assets to create “tangible equity” facilitates the comparison of results for ongoing business operations. The Company’s management internally assesses its performance based, in part, on these non-GAAP financial measures. The following table sets forth a reconciliation of total shareholders' equity to tangible shareholder's equity for the periods presented.

Reconciliation to Tangible Common Shareholders’ Equity:

	December 31,		
	2018	2017	2016
	(dollars in thousands)		
Total shareholders' equity	$74,721	$76,921	$83,850
Less:			
Other intangible assets (goodwill)	(16,321)	(16,321)	(16,321)
Tangible common shareholders' equity	$58,400	$60,600	$67,529

Critical Accounting Policies

General

The Company's financial statements are prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). The financial information contained within our statements is, to a significant extent, financial information that is based on measures of the financial effects of transactions and events that have already occurred. We use historical loss data and the economic environment as factors, among others, in determining the inherent loss that may be present in our loan and lease portfolio. Actual losses could differ significantly from the factors that we use. In addition, GAAP itself may change from one previously acceptable method to another method. Although the economics of our transactions would be the same, the timing of events that would impact our transactions could change.

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Allowance for Loan and Lease Losses

The allowance for loan and lease losses is an estimate of probable credit losses inherent in the Company's credit portfolio that have been incurred as of the balance-sheet date. The allowance is based on two basic principles of accounting: (1) "Accounting for Contingencies," which requires that losses be accrued when it is probable that a loss has occurred at the balance sheet date and such loss can be reasonably estimated; and (2) the "Receivables" topic, which requires that losses be accrued on impaired loans based on the differences between the value of collateral, present value of future cash flows or values that are observable in the secondary market and the loan balance.

The allowance for loan and lease losses is determined based upon estimates that can and do change when the actual risk, loss events, or changes in other factors, occur. The analysis of the allowance uses a historical loss view as an indicator of future losses and as a result could differ from the actual losses incurred in the future. If the allowance for loan and lease losses falls below that deemed adequate (by reason of loan and lease growth, actual losses, the effect of changes in risk factors, or some combination of these), the Company has a strategy for supplementing the allowance for loan and lease losses, over the short-term. For further information regarding our allowance for loan and lease losses, see "Allowance for Loan and Lease Losses Activity."

Stock-Based Compensation

The Company recognizes compensation expense over the service period in an amount equal to the fair value of all share-based payments which consist of stock options and restricted stock awarded to directors and employees. The fair value of each stock option award is estimated on the date of grant and amortized over the service period using a Black-Scholes-Merton based option valuation model that requires the use of assumptions. Critical assumptions that affect the estimated fair value of each award include expected stock price volatility, dividend yields, option life and the risk-free interest rate. The fair value of each restricted award is estimated on the date of award and amortized over the service period.

Overview

The Company recorded net income in 2018 of $4,900,000, an increase of $1,702,000 (53.2%) from $3,198,000 in 2017. Diluted earnings per share were $0.83 for 2018 and $0.50 for 2017. For 2018, the Company realized a return on average equity of 6.77% and a return on average assets of 0.72%, compared to 3.91% and 0.49%, respectively, in 2017.

Net income for 2017 decreased $3,206,000 (50.1%) from $6,404,000 in 2016. Diluted earnings per share for 2016 were $0.94. For 2016, the Company realized a return on average equity of 7.60% and return on average assets of 1.00%. Table One below provides a summary of the components of net income for the years indicated (dollars in thousands):

Table One: Components of Net Income

	2018	2017	2016
Interest income*	$22,449	$20,804	$21,618
Interest expense	(1,596)	(1,061)	(910)
Net interest income*	20,853	19,743	20,708
Provision for loan and lease losses (expense) income	(175)	(450)	1,344
Noninterest income	1,513	1,596	2,045
Noninterest expense	(15,510)	(14,049)	(13,836)
Provision for income taxes	(1,574)	(3,252)	(3,392)
Tax equivalent adjustment	(207)	(390)	(465)
Net income	$4,900	$3,198	$6,404
Average total assets	$681,630	$652,720	$638,276
Net income as a percentage of average total assets	0.72 %	0.49 %	1.00 %

* Fully taxable equivalent basis (FTE)

During 2018, total assets of the Company increased $32,470,000 (5.0%) from $655,622,000 at December 31, 2017 to $688,092,000 at December 31, 2018. At December 31, 2018, net loans totaled $318,516,000, an increase of $9,803,000 (3.2%) from the ending balance of $308,713,000 at December 31, 2017. Deposits increased $34,594,000 or 6.2% from $556,080,000 at December 31, 2017 to $590,674,000 at December 31, 2018. Shareholders' equity decreased $2,200,000 or 2.9% from $76,921,000 at December 31, 2017 to $74,721,000 at December 31, 2017. The Company ended 2018 with a leverage capital ratio of 8.9% and a total risk-based capital ratio of 17.3% compared to a leverage capital ratio of 9.5% and a total risk-based capital ratio of 19.3% at the end of 2017.

Results of Operations

Net Interest Income and Net Interest Margin

Net interest income represents the excess of interest and fees earned on interest earning assets (loans, securities, Federal funds sold and interest-bearing deposits in other banks) over the interest paid on deposits and borrowed funds. Net interest margin is net interest income expressed as a percentage of average earning assets.

The Company's fully taxable equivalent net interest margin was 3.41% in 2018, 3.39% in 2017, and 3.62% in 2016. The fully taxable equivalent net interest income increased $1,110,000 (5.6%), from $19,743,000 in 2017 to $20,853,000 in 2018. The fully taxable equivalent net interest income decreased $965,000 (4.7%), from $20,708,000 in 2016 to $19,743,000 in 2017.

The fully taxable equivalent interest income component increased $1,645,000 (7.9%) from $20,804,000 in 2017 to $22,449,000 in 2018. The increase in the fully taxable equivalent interest income for 2018 compared to the same period in 2017 is comprised of two components - rate (up $1,764,000) and volume (down $119,000). The primary driver in this rate increase was an increase in the yield on loans which saw an increase from 4.57% in 2017 to 4.72% in 2018 and an increase in the yield on investments, which saw an increase from 2.36% in 2017 to 2.66% in 2018. The increased yield in 2018 compared to 2017 was due to the overall higher interest rate environment. The yield on earning assets increased from 3.57% during 2017 to 3.67% during 2018. The increase in yield from the loans and investments was partially offset by an increase in the balances of Federal funds sold. Federal funds sold balances increased from zero in 2017 to an average balance of $18,688,000 in 2018. However, the yield on these lower earning Federal fund balances was 1.86%, thus partially reducing the overall yield on earning assets. The volume decrease of $119,000 was primarily from a decrease in loans ($515,000), partially offset by an increase in investment balances ($391,000). Average loans balances decreased $11,266,000, (or 3.5%), from $319,631,000 during 2017 to $308,365,000 during 2018 and the average investment balances increased $21,344,000, (or 8.2%), from $261,554,000 during 2017 to $282,898,000 in 2018.

The fully taxable equivalent interest income component decreased $814,000 (3.8%) from $21,618,000 in 2016 to $20,804,000 in 2017. The decrease in the fully taxable equivalent interest income for 2017 compared to the same period in 2016 is comprised of two components - rate (down $1,337,000) and volume (up $523,000). The rate decrease primarily occurred in the loan and investment portfolios. While average loans increased by $12,894,000 (4.2%) from $306,737,000 during 2016 to $319,631,000 during 2017, due to the overall lower interest rate environment in 2017, the new loans added were at lower yields than the existing loans. The yield on loans decreased from 4.88% in 2016 to 4.57% in 2017 and contributed to a decrease of $961,000 in loan interest income. The investment portfolio also contributed to the decrease in interest income. The yield on the investments decreased from 2.51% in 2016 to 2.36% in 2017 and contributed to a decrease of $379,000 in interest income. This decrease in investment income due to rates can also be attributed to the lower overall rate environment as proceeds from paid down securities were invested at lower rates. The volume increase of $523,000 was primarily from the increase of $12,894,000 in average loans mentioned above contributing $600,000 in interest income and partially offset by the decrease in investments reducing interest income by $80,000. When compared to 2016, average investment securities decreased $2,622,000 (1.0%) from $264,176,000 in 2016 compared to $261,554,000 in 2017, as a portion of these funds helped fund the increase in loans.

Interest expense was $535,000 (or 50.4%) higher in 2018 compared to 2017, increasing from $1,061,000 to $1,596,000. The $535,000 increase in interest expense during 2018 compared to 2017 was due to higher rates (up $531,000) and higher volume (up $4,000). The increase in interest expense can be attributed to an increase in rates paid on deposit and borrowing balances during a higher interest rate environment. Rates paid on interest bearing liabilities increased 11 basis points from 0.30% to 0.41% for 2017 compared to 2018. The largest increase due to rates occurred in the time deposits. Some of these time deposits are indexed to the three- or six-month treasury rates which have increased over the past twelve months. Interest expense on time deposits increased by $367,000, (or 52.9%), from $694,000 in 2017 to $1,061,000 in 2018 while the average time deposit balances decreased by $1,634,000, (or 2.0%), from $81,056,000 in 2017 to $79,422,000 in 2018.

Interest expense was $151,000 (16.6%) higher in 2017 compared to 2016, increasing from $910,000 to $1,061,000. The primary increase in interest expense relates to higher rates (up $177,000). Rates paid on interest bearing liabilities increased four basis points from 0.26% to 0.30% in 2017 compared to 2016. The average balances on interest bearing liabilities were $358,756,000 (or $7,661,000 and 2.2% higher) in 2017 compared to $351,095,000 in 2016. Despite the slightly higher average balances, the Company experienced a slight decrease in interest expense of $26,000 due to volume as a result of a decrease in the higher cost time deposits and other borrowings. Time deposits decreased from $83,144,000 in 2016 to $81,056,000 in 2017 and had a $14,000 impact on the decrease in interest expense due to volume and other borrowings decreased from $17,201,000 in 2016 to $15,522,000 in 2017 and had an $18,000 impact on the decrease in interest expense due to volume.

Table Two, Analysis of Net Interest Margin on Earning Assets, and Table Three, Analysis of Volume and Rate Changes on Net Interest Income and Expenses, are provided to enable the reader to understand the components and past trends of the Company's interest income and expenses. Table Two provides an analysis of net interest margin on earning assets setting forth average assets, liabilities and shareholders' equity; interest income earned and interest expense paid and average rates earned and paid; and the net interest margin on earning assets. Table Three sets forth a summary of the changes in interest income and interest expense from changes in average asset and liability balances (volume), computed on a daily average basis, and changes in average interest rates.

Table Two: Analysis of Net Interest Margin on Earning Assets

Year Ended December 31,	2018			2017			2016		
(Taxable Equivalent Basis) (dollars in thousands)	Avg Balance	Interest	Avg Yield	Avg Balance	Interest	Avg Yield	Avg Balance	Interest	Avg Yield
Assets:									
Earning assets:									
Taxable loans and leases (1)	$294,114	$13,924	4.73%	$305,345	$13,947	4.57 %	$289,699	$14,008	4.84
Tax-exempt loans and leases (2)	14,251	632	4.43%	14,286	667	4.67 %	17,038	967	5.68
Taxable investment Securities	264,247	6,901	2.61%	238,710	5,287	2.21 %	240,149	5,755	2.40
Tax-exempt investment securities (2)	18,651	611	3.28%	22,789	874	3.84 %	23,952	867	3.62
Corporate stock	—	—	—	55	16	29.09%	75	14	18.67
Federal funds sold	18,688	348	1.86%	—	—	—	—	—	—
Interest bearing deposits in other banks	1,745	33	1.89%	1,258	13	1.03 %	996	7	0.70
Total earning assets	611,696	22,449	3.67%	582,443	20,804	3.57 %	571,909	21,618	3.78
Cash & due from banks	34,535			35,876			33,806		
Other assets	39,822			39,201			37,753		
Allowance for loan & lease losses	(4,423)			(4,800)			(5,192)		
	$681,630			$652,720			$638,276		
Liabilities & Shareholders' Equity:									
Interest bearing liabilities:									
NOW & MMDA	$219,742	272	0.12%	$197,298	139	0.07 %	$190,237	146	0.08
Savings	71,742	26	0.04%	64,880	22	0.03 %	60,543	19	0.03
Time deposits	79,422	1,061	1.34%	81,056	694	0.86 %	83,114	565	0.68
Other borrowings	15,533	237	1.53%	15,522	206	1.33 %	17,201	180	1.05
Total interest bearing liabilities	386,439	1,596	0.41%	358,756	1,061	0.30 %	351,095	910	0.26

Demand deposits	215,721			204,565			196,434		
Other liabilities	7,062			7,583			6,494		
Total liabilities	609,222			570,904			554,023		
Shareholders’ equity	72,408			81,816			84,253		
	$681,630			$652,720			$638,276		
Net interest income & margin (3)		$20,853	3.41%		$19,743	3.39 %		$20,708	3.62

(1) Loan and lease interest includes loan and lease fees of $533,000, $238,000 and $253,000 in 2018, 2017 and 2016, respectively.

(2) Includes taxable-equivalent adjustments that primarily relate to income on certain loans and securities that is exempt from federal income taxes. The effective federal statutory tax rate was 21% in 2018 and 34% in 2017 and 2016.

(3) Net interest margin is computed by dividing net interest income by total average earning assets.

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Table Three: Analysis of Volume and Rate Changes on Net Interest Income and Expenses
Year ended December 31, 2018 over 2017 (dollars in thousands)
Increase (decrease) in interest income and expense due to change in:

Interest-earning assets:	Volume	Rate (4)	Net Change
Taxable net loans and leases (1)(2)	$ (513)	$ 490	$ (23)
Tax-exempt net loans and leases (3)	(2)	(33)	(35)
Taxable investment securities	566	1,048	1,614
Tax-exempt investment securities (3)	(159)	(104)	(263)
Corporate stock	(16)	—	(16)
Federal funds sold	—	348	348
Interest bearing deposits in other banks	5	15	20
Total	(119)	1,764	1,645
Interest-bearing liabilities:			
Demand deposits	16	117	133
Savings deposits	2	2	4
Time deposits	(14)	381	367
Other borrowings	—	31	31
Total	4	531	535
Interest differential	$ (123)	$ 1,233	$ 1,110

Year Ended December 31, 2017 over 2016 (dollars in thousands) Increase (decrease) in interest income and expense due to change in:

Interest-earning assets:	Volume	Rate (4)	Net Change
Taxable net loans and leases (1)(2)	$ 757	$ (818)	$ (61)
Tax-exempt net loans and leases (3)	(156)	(144)	(300)
Taxable investment securities	(34)	(434)	(468)
Tax-exempt investment securities (3)	(42)	49	7
Corporate stock	(4)	6	2
Federal funds sold	—	—	—
Interest bearing deposits in other banks	2	4	6
Total	523	(1,337)	(814)
Interest-bearing liabilities:			
Demand deposits	5	(12)	(7)
Savings deposits	1	2	3
Time deposits	(14)	143	129
Other borrowings	(18)	44	26
Total	(26)	177	151
Interest differential	$ 549	$ (1,514)	$ (965)

(1) The average balance of non-accruing loans and leases is immaterial as a percentage of total loans and leases and has been included in net loans and leases.

(2) Loan and lease fees of $533,000, $238,000 and $253,000 for the years ended December 31, 2018, 2017 and 2016, respectively, have been included in the interest income computation.

(3) Includes taxable-equivalent adjustments that primarily relate to income on certain loans and securities that is exempt from federal income taxes. The effective federal statutory tax rate was 21% in 2018 and 34% in 2017 and 2016.

(4) The rate/volume variance has been included in the rate variance.

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Provision for Loan and Lease Losses

The Company experienced net loan and lease losses of $261,000 or 0.08% of average loans and leases during 2018, compared to net loan and lease losses of $794,000 or 0.25% of average loans and leases during 2017. To support the net losses in 2018 and 2017, the Company recorded provisions for loan and lease losses of $175,000 and $450,000, respectively during 2017 and 2018. The Company experienced net loan and lease recoveries of $1,191,000 or 0.39% of average loans and leases during 2016 and as a result was able to record a negative provision for loan and lease losses of $1,344,000. The level of nonperforming loans and leases, which began to increase during the economic cycle of 2007 through 2010, reached a high of $22,571,000 at December 31, 2010, but has decreased to $27,000 at December 31, 2018. For additional information see the "Nonaccrual, Past Due and Restructured Loans and Leases" and the "Allowance for Loan and Lease Losses Activity."

Noninterest Income

Table Four below provides a summary of the components of noninterest income for the periods indicated (dollars in thousands):

Table Four:
Components
of
Noninterest
Income

	Year Ended December 31,		
	2018	2017	2016
Service charges on deposit accounts	$476	$465	$502
Income from OREO properties	—	—	279
Merchant fee income	422	411	377
Earnings on bank-owned life insurance	307	317	322
Gain on sale and impairment of securities	31	161	314
Other	277	242	251
	$1,513	$1,596	$2,045

Noninterest income decreased $83,000 (5.2%) to $1,513,000 in 2018 from $1,596,000 in 2017. The decrease from 2017 to 2018 was primarily related to lower gains on sale of securities. Gain on sales of securities decreased $130,000 (81.3%) from 2017 to 2018.

Noninterest income decreased $449,000 (22.0%) to $1,596,000 in 2017 from $2,045,000 in 2016. The decrease from 2016 to 2017 was primarily related to lower gains on sale of securities and lower earnings on OREO properties. Gain on sales of securities decreased $153,000 (48.7%) from 2016 to 2017 and income from OREO properties decreased $279,000 (100.0%) during that same time period. The decrease in OREO income resulted from the sale of the Bank's only remaining income producing OREO property in the first quarter of 2016.

Noninterest Expense

Salaries and Benefits

Salaries and benefits were $10,203,000 (up $1,283,000 or 14.4%) for 2018, compared to $8,920,000 in 2017. The increase in salaries and benefits expense resulted from filling some vacant positions, hiring additional relationship managers, creating a position for a Chief Lending Officer in December 2017, and normal cost of living increases and promotions. Average full-time equivalent employees was 97 during 2018 compared to 93 during 2017. Employer benefit expenses, such as insurance, 401(k) matching and incentives and payroll taxes increased commensurate with the increased staffing levels.

Salaries and benefits were $8,920,000 (up $485,000 or 5.7%) for 2017, compared to $8,435,000 in 2016. The increase in salary and benefits was due in part to expenses related to a change in the Company's Chief Executive Officer during the fourth quarter of 2017. This leadership change was announced on October 27, 2017, on a Form 8-K filed with the Securities and Exchange Commission. The leadership change resulted in salary and benefit expenses of $597,000 in 2017. The expenses related to the leadership change were partially offset by lower salary expenses. Salary expenses decreased $206,000 (3.5%) from $5,853,000 in 2016 to $5,647,000 in 2017. The decrease in salaries resulted from a lower number of average full time equivalent employees, which decreased from 98 in 2016 to 93 in 2017.

Other Real Estate Owned

The total other real estate owned (“OREO”) expense in 2018 was $20,000 (down $24,000 or 54.5%) compared to $44,000 in 2017. The primary reason for the decrease in OREO related expenses was due to the sale of one of the properties in the third quarter of 2017. Operating expenses on the properties held in 2017 totaled $52,000 compared to $16,000 in 2018. In 2017, the gains on sale, which offset the overall OREO expense, were $8,000 compared to zero in 2018. There were no write-downs on any of the properties held during 2017 compared to write-downs of $4,000 in 2018. At December 31, 2018, the Company held one property with a book value of $957,000.

The total OREO expense in 2017 was $44,000 (down $202,000 or 82.1%) compared to $246,000 in 2016. The primary reason for the decrease in OREO related expenses was due to the sale of a number of properties, including office buildings which have high operating expenses, and lower property write-downs. Operating expenses on the properties held in 2017 totaled $52,000 compared to $128,000 in 2016. In 2017, the gains on sale, which offset the overall OREO expense, were lower than in 2016. Gains from properties sold in 2017 totaled $8,000 compared to a $258,000 in 2016. There were no write-downs on any of the properties held during 2017 compared to write-downs of $376,000 in 2016. At December 31, 2017, the Company held one property with a book value of $961,000.

Occupancy, Furniture and Equipment

Occupancy expense decreased $3,000 (0.3%) during 2018 to $1,050,000, compared to $1,053,000 in 2017. Furniture and equipment expense decreased $33,000 (5.6%) during 2018 to $553,000 compared to $586,000 in 2017. The decrease in occupancy and furniture and equipment expense decrease resulted from lower depreciation expense on premises and equipment leased or owned by the Company.

Occupancy expense decreased $122,000 (10.4%) during 2017 to $1,053,000, compared to $1,175,000 in 2016. Furniture and equipment expense decreased $66,000 (10.1%) during 2017 to $586,000 compared to $652,000 in 2016. The decrease in occupancy resulted from the Company renewing leases at more favorable terms or relocating branch offices to smaller locations. The furniture and equipment expense decrease resulted from lower depreciation expense on equipment owned by the Company.

Regulatory Assessments

Regulatory assessments include fees paid to the California Department of Business Oversight (the “DBO”) and the Federal Deposit Insurance Corporation (the “FDIC”). FDIC assessments decreased $4,000 (1.9%) during 2018 to $202,000, compared to $206,000 in 2017. The assessments paid to the DBO in 2018 were $77,000, compared to an expense of $74,000 in 2017.

FDIC assessments decreased $50,000 (19.5%) during 2017 to $206,000, compared to $256,000 in 2016. The majority of this decrease resulted from a lower assessment rate as a result of the Deposit Insurance Fund achieving the FDIC's target level of 1.15% during 2016, which resulted in lower assessments for community banks such as American River Bank. The assessments paid to the DBO in 2017 were $74,000, compared to an expense of $72,000 in 2016.

Other Expenses

Table Five below provides a summary of the components of the other noninterest expenses for the periods indicated (dollars in thousands):

	Year Ended December 31,		
	2018	2017	2016
Professional fees	$1,158	$1,140	$995
Outsourced item processing	315	319	366
Directors' expense	514	427	417
Telephone and postage	409	360	357
Stationery and supplies	140	135	141
Advertising and promotion	480	175	129
Other operating expenses	388	610	595
	$3,404	$3,166	$3,000

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Other expenses were $3,404,000 (up $238,000 or 7.5%) for 2018, compared to $3,166,000 for 2017. The increase in other expenses occurred primarily in the advertising and promotion expense category. Advertising and promotion expense increased $305,000 (174.3%), from $175,000 in 2017 to $480,000 in 2018. Much of this increase is related to the expenses to sponsor community events and other promotional activities as the Company is focusing more effort in our markets to strengthen our brand. The overhead efficiency ratio on a taxable equivalent basis for 2018 was 69.4% compared to 65.8% in 2017.

Other expenses were $3,166,000 (up $166,000 or 5.5%) for 2017, compared to $3,000,000 for 2016. The increase in other expenses occurred primarily in the professional expense category. Professional expenses, which primarily include legal, accounting and other professional services, increased $145,000 (14.6%), from $995,000 in 2016 to $1,140,000 in 2017. Much of this increase is related to the leadership change that occurred during the fourth quarter of 2017 resulting in professional expenses of $78,000 and fees paid in 2017 related to strategic planning consulting of $38,000. The overhead efficiency ratio on a taxable equivalent basis for 2017 was 65.8% compared to 60.8% in 2016.

Provision for Income Taxes

The effective tax rate on income was 24.3%, 50.4%, and 34.6% in 2018, 2017 and 2016, respectively. The effective tax rate differs from the federal statutory tax rate due to state tax expense (net of federal tax effect) of $523,000, $420,000, and $697,000 in these years. Tax-exempt income of $1,315,000, $1,471,000, and $1,681,000 from investment securities, loans, and bank-owned life insurance in these years helped to reduce the effective tax rate. The lower effective tax rate in 2018 compared to prior years results from the new lower corporate federal income tax rate of 21% effective January 1, 2018, which was a reduction from the Company's 2017 and 2016 rate of 34%. The higher effective tax rate in 2017 compared to 2016 resulted from the Company recording an income tax expense adjustment of $1,220,000 related to "H.R.1" commonly referred to as the Tax Cuts and Jobs Act that was signed into law on December 22, 2017. The adjustment relates to revaluing the Company's net deferred tax assets using the new lower corporate federal income tax rate of 21%.

The Company's taxable income in 2018 was $6,474,000 up slightly from $6,450,000 in 2017, however, the combined federal and State income tax expense decreased $1,678,000 (51.6%) from $3,252,000 in 2017 to $1,574,000 in 2018. Excluding the $1,220,000 adjustment related to H.R.1, the tax expense would have been $2,032,000 in 2017. Comparing the actual expense of $1,574,000 in 2018 to the adjusted expense of $2,032,000 in 2017 points out the benefit of the lower 21% federal tax rate.

Balance Sheet Analysis

The Company's total assets were $688,092,000 at December 31, 2018 compared to $655,622,000 at December 31, 2017, representing an increase of $32,470,000 (5.0%). The average balances of total assets during 2018 were $681,630,000, up $28,910,000 or 4.4% from the 2017 average balances of total assets of $652,720,000.

Investment Securities

The Company classifies its investment securities as trading, held-to-maturity or available-for-sale. The Company’s intent is to hold all securities classified as held-to-maturity until maturity and management believes that it has the ability to do so. Securities classified as available-for-sale may be sold to implement asset/liability management strategies as part of our contingency funding plan and in response to changes in interest rates, prepayment rates and similar factors. Table Six below summarizes the values of the Company’s investment securities held on December 31 of the years indicated. The Company did not have any investment securities classified as trading in any of the years indicated below.

Table Six: Investment Securities Composition

(dollars in thousands)

Available-for-sale (at fair value)	2018	2017	2016
Debt securities:			
US Government Agencies and US Government-Sponsored Agencies	$269,049	$232,869	$229,785
Obligations of states and political subdivisions	14,400	22,715	22,612
Corporate debt securities	6,508	6,626	1,519
U. S Treasury securities	4,976	—	—
Equity securities:			
Corporate stock	—	112	104
Total available-for-sale investment securities	$294,933	$262,322	$254,020
Held-to-maturity (at amortized cost)			
Debt securities:			
US Government Agencies and US Government-Sponsored Agencies	$292	$378	$483
Total held-to-maturity investment securities	$292	$378	$483

Net unrealized losses on available-for-sale investment securities totaling $2,664,000 were recorded, net of $788,000 in tax liabilities, as accumulated other comprehensive income within shareholders' equity at December 31, 2018 and net unrealized gains on available-for-sale investment securities totaling $456,000 were recorded, net of $135,000 in tax liabilities, as accumulated other comprehensive income within shareholders' equity at December 31, 2017. Management periodically evaluates each investment security in a loss position for other than temporary impairment relying primarily on industry analyst reports, observation of market conditions and interest rate fluctuations. Management has the ability and intent to hold securities with established maturity dates until recovery of fair value, which may be until maturity, and believes it will be able to collect all amounts due according to the contractual terms for all of the underlying investment securities; therefore, management does not consider these investments to be other-than-temporarily impaired. See Table Fifteen, "Securities Maturities and Weighted Average Yields," for a breakdown of the investment securities by maturity and the corresponding weighted average yields.

Loans and Leases

The Company concentrates its lending activities in the following principal areas: (1) commercial; (2) commercial real estate; (3) multi-family real estate; (4) real estate construction (both commercial and residential); (5) residential real estate; (6) lease financing receivable; (7) agriculture; and (8) consumer loans. At December 31, 2018, these categories accounted for approximately 9%, 62%, 18%, 2%, 5%, 0%, 1% and 3%, respectively, of the Company's loan portfolio. This mix was relatively unchanged compared to approximately 8%, 59%, 25%, 2%, 5%, 0%, 1% and 0%, respectively, at December 31, 2016. Also, as noted in Table 7 below, the Company's primary focus is commercial and real estate loans, however, in 2018 the Company was selected by a lender that specializes in classic and collector cars. The company began funding these loans during the third quarter of 2018 and recorded $10,791,000 during 2018 and account for the increase in consumer loans.

Continuing focus in the Company's market area, new borrowers developed through the Company's marketing efforts, an upgraded lending team in 2018, and credit extensions expanded to existing borrowers resulted in the Company originating approximately $104 million in loans compared to $30 million in 2017. This production was offset by normal pay downs and payoffs, and resulted in an overall net increase in net loans and leases of $9.8 million (3.2%) from December 31, 2017. The market in which the Company operates has shown increased demand for credit products as the relatively low rate environment and expectations for economic expansion have increased refinancing as well as new loan activity. Table Seven below summarizes the composition of the loan and lease portfolio for the past five years as of December 31.

Table Seven: Loan and Lease Portfolio Composition

	December 31,				
(dollars in thousands)	2018	2017	2016	2015	2014
Commercial	$29,650	$25,377	$35,374	$36,195	$25,186
Real estate:					
Commercial	199,894	185,452	191,129	199,591	193,871
Multi-family	56,139	78,025	73,373	23,494	14,167
Construction	5,685	5,863	9,180	14,533	8,028
Residential	16,338	15,813	15,718	14,200	13,309
Lease financing receivable	32	205	404	732	1,286
Agriculture	4,419	1,713	2,302	2,431	2,882
Consumer	10,714	945	1,650	3,122	4,916
	322,871	313,393	329,130	294,298	263,645
Deferred loan fees and costs, net	37	(202)	(222)	(221)	(287)
Allowance for loan and lease losses	(4,392)	(4,478)	(4,822)	(4,975)	(5,301)
Total net loans and leases	$318,516	$308,713	$324,086	$289,102	$258,057

A significant portion of the Company’s loans and leases are direct loans and leases made to individuals and local businesses. The Company relies substantially on networking, local promotional activity, and personal contacts by American River Bank officers, directors and employees to compete with other financial institutions. The Company makes loans and leases to borrowers whose applications include a sound purpose and a viable primary repayment source, generally supported by a secondary source of repayment.

Commercial loans consist of credit lines for operating needs, loans for equipment purchases, working capital, and various other business loan products. Consumer loans include a range of traditional consumer loan products such as personal lines of credit and homeowner equity lines of credit and loans to finance purchases of autos (including classic and collectors autos), boats, recreational vehicles, mobile homes and various other consumer items. Construction loans are generally comprised of commitments to customers within the Company’s service area for construction of commercial properties, multi-family properties and custom and semi-custom single-family residences. Other real estate loans consist primarily of loans secured by first trust deeds on commercial, multi-family, and residential properties typically with maturities from 3 to 10 years and original loan-to-value ratios generally from 65% to 75%. Agriculture loans consist primarily of vineyard loans. In general, except in the case of loans under SBA programs or Farm Services Agency guarantees, the Company does not make long-term mortgage loans.

Average loans and leases in 2018 were $308,365,000, which represents a decrease of $11,266,000 (3.5%) compared to the average in 2017. Average loans and leases in 2017 were $319,631,000, which represents an increase of $12,894,000 (4.2%) compared to the average in 2016.

Risk Elements

The Company assesses and manages credit risk on an ongoing basis through a total credit culture that emphasizes excellent credit quality, extensive internal monitoring and established formal lending policies. Additionally, the

Company contracts with an outside loan review consultant to periodically review the existing loan and lease portfolio. Management believes its ability to identify and assess risk and return characteristics of the Company's loan and lease portfolio is critical for profitability and growth. Management strives to continue its emphasis on credit quality in the loan and lease approval process, through active credit administration and regular monitoring. With this in mind, management has designed and implemented a comprehensive loan and lease review and grading system that functions to continually assess the credit risk inherent in the loan and lease portfolio.

Ultimately, underlying trends in economic and business cycles influence credit quality. American River Bank's business is concentrated in the Sacramento Metropolitan Statistical Area, which is a diversified economy, but with a large State of California government presence and employment base; in Sonoma County, which is focused on businesses within the two communities in which the Bank has offices (Santa Rosa and Healdsburg); and in Amador County, in which the Bank is primarily focused on businesses within the three communities in which it has offices (Jackson, Pioneer, and Ione). The economy of Sonoma County is diversified with professional services, manufacturing, agriculture and real estate investment and construction, while the economy of Amador County is reliant upon government, services, retail trade, manufacturing industries and Indian gaming. The Company serviced markets in Santa Clara, Contra Costa, and Alameda Counties through a loan production office. In the fourth quarter of 2016, the Company discontinued operating the loan production office, however, the Company continues to service loans originated through these offices. The economies of Santa Clara, Contra Costa and Alameda Counties are diversified with professional services, manufacturing, technology related companies, real estate investment and construction.

The Company has significant extensions of credit and commitments to extend credit that are secured by real estate. The ultimate repayment of these loans is generally dependent on personal or business cash flows or the sale or refinancing of the real estate. The Company monitors the effects of current and expected market conditions and other factors on the collectability of real estate loans. The more significant factors management considers involve the following: lease rates and terms, vacancy rates, absorption and sale rates and capitalization rates; real estate values, supply and demand factors, and rates of return; operating expenses; inflation and deflation; and sufficiency of repayment sources independent of the real estate including, in some instances, personal guarantees.

In extending credit and commitments to borrowers, the Company generally requires collateral and/or guarantees as security. The repayment of such loans is expected to come from cash flows or from proceeds from the sale of selected assets of the borrowers. The Company's requirement for collateral and/or guarantees is determined on a case-by-case basis in connection with management's evaluation of the creditworthiness of the borrower. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment, income-producing properties, residences and other real property. The Company secures its collateral by perfecting its security interest in business assets, obtaining deeds of trust, or outright possession among other means.

In management's judgment, a concentration exists in real estate loans which represented approximately 87% of the Company's loan and lease portfolio at December 31, 2018 and 91% at December 31, 2017. Management believes that the residential land portion of the Company's loan portfolio carries a reasonable level of credit risk. As of December 31, 2018, outstanding unimproved residential land commitments were $4,889,000 (or just 1.5% of the total real estate loans). Of the $4,889,000, $2,097,000 (43%) was represented by one amortizing loan, which was considered well-secured, with a favorable loan-to-value ratio. Management currently believes that it maintains its allowance for loan and lease losses at levels adequate to reflect the loss risk inherent in its total loan portfolio.

A decline in the economy in general, or decline in real estate values in the Company's market areas, in particular, could have an adverse impact on the collectability of real estate loans and require an increase in the provision for loan and lease losses. This could adversely affect the Company's future prospects, results of operations, profitability and stock price. Management believes that its lending practices and underwriting standards are structured with the intent to minimize losses; however, there is no assurance that losses will not occur. The Company's loan practices and underwriting standards include, but are not limited to, the following: (1) maintaining a thorough understanding of the Company's market area and originating a significant majority of its loans within that area, (2) maintaining a thorough understanding of borrowers' knowledge, capacity, and market position in their field of expertise, (3) basing real estate loan approvals not only on market demand for the project, but also on the borrowers' capacity to support the project financially in the event it does not perform to expectations (whether sale or income performance), and (4) maintaining conforming and prudent loan-to-value and loan-to-cost ratios based on independent outside appraisals and ongoing inspection and analysis by the Company's lending officers or contracted third-party professionals.

Nonaccrual, Past Due and Restructured Loans and Leases

Management places loans and leases on nonaccrual status when they become 90 days past due or if a loss is expected, unless the loan or lease is well secured and in the process of collection. Loans and leases are partially or fully charged off when, in the opinion of management, collection of such amount appears unlikely.

The recorded investments in nonperforming loans and leases, which includes nonaccrual loans and leases and loans and leases that were 90 days or more past due and on accrual, totaled $27,000 and $1,892,000 at December 31, 2018 and 2017, respectively. The $27,000 in nonperforming loans and leases at December 31, 2018 were comprised of one commercial loan relationship with two loans totaling $27,000, both of which were current to terms. At December 31, 2017, the $1,892,000 in nonperforming loans consisted of one commercial loan totaling $1,597,000, one commercial real estate loan totaling $289,000, and one consumer loan totaling $6,000. At December 31, 2018, there were no loans that were 30 days or more past due. Table Eight below sets forth nonaccrual loans and leases and loans and leases past due 90 days or more and on accrual as of year-end for the past five years.

Table Eight: Nonperforming Loans and Leases

	December 31,				
(dollars in thousands)	2018	2017	2016	2015	2014
Past due 90 days or more and still accruing:					
Commercial	$—	$—	$ —	$—	$—
Real estate	—	—	—	—	—
Lease financing receivable	—	—	—	—	—
Consumer and other	—	—	—	—	—
Nonaccrual:					
Commercial	27	1,597	—	30	666
Real estate	—	289	—	1,493	845
Lease financing receivable	—	—	—	—	—
Consumer and other	—	6	19	120	142
Total nonperforming loans and leases	$27	$1,892	$ 19	$1,643	$1,653

Restructured loans considered performing and accruing at December 31, 2018, 2017, 2016, 2015 and 2014, were $6,626,000, $6,799,000, $7,975,000, $8,062,000, and $13,098,000, respectively.

Interest income recognized from payments received on nonaccrual loans and leases was approximately $43,000 in 2018, $2,000 in 2017 and $115,000 in 2016. There were no loan or lease concentrations in excess of 10% of total loans and leases not otherwise disclosed as a category of loans and leases as of December 31, 2018. Management is not aware of any potential problem loans, which were accruing and current at December 31, 2018, where serious doubt exists as to the ability of the borrower to comply with the present repayment terms and that would result in a significant loss to the Company apart from those loans identified in the Bank’s impairment analysis.

Management monitors the Company’s performance metrics including the ratios related to nonperforming loans and leases. From 2008 to 2010, the Company experienced an increase in nonperforming loans and leases. In 2011, the focused efforts of the previous years resulted in a decrease in these levels. From 2012 to 2018, the level of nonperforming loans and leases continued to decrease to a level below the amount reported at December 31, 2008. However, the variations in the amount of nonperforming loans and leases does not directly impact the level of the Company’s allowance for loan and lease losses as management monitors each of the loans and leases for loss potential or probability of loss on an individual basis using accounting principles generally accepted in the United States of America.

Impaired Loans and Leases

The Company considers a loan to be impaired when, based on current information and events, it is probable that it will be unable to collect all amounts due (principal and interest) according to the original contractual terms of the loan or lease agreement. The measurement of impairment may be based on (i) the present value of the expected cash flows of the impaired loan or lease discounted at the loan’s or lease’s original effective interest rate, (ii) the observable market price of the impaired loan or lease, or (iii) the fair value of the collateral of a collateral-dependent loan. The Company does not apply this definition to smaller-balance loans or leases that are collectively evaluated for credit risk. In assessing whether a loan or lease is impaired, the Company typically reviews loans or leases graded substandard or lower with outstanding principal balances in excess of $100,000, as well as loans considered troubled debt restructures with outstanding principal balances in excess of $25,000. The Company identifies troubled debt restructures by reviewing each renewal, modification, or extension of a loan with a screening document. This document is designed to identify any characteristics of such a loan that would qualify it as a troubled debt restructure. If the characteristics are not present that would qualify a loan as a troubled debt restructure, it is deemed to be a modification.

The recorded investment in loans and leases that were considered to be impaired totaled $8,702,000 at December 31, 2018 and had a related valuation allowance of $185,000. The average recorded investment in impaired loans and leases during 2018 was approximately $8,847,000. As of December 31, 2017, the recorded investment in loans and leases that were considered to be impaired totaled $13,757,000 and had a related valuation allowance of $355,000. The average recorded investment in impaired loans and leases during 2017 was approximately $14,046,000. As of December 31, 2016, the recorded investment in loans and leases that were considered to be impaired totaled $17,297,000 and had a related valuation allowance of $421,000. The average recorded investment in impaired loans and leases during 2016 was approximately $17,503,000.

Allowance for Loan and Lease Losses Activity

The Company maintains an allowance for loan and lease losses (“ALLL”) to cover probable losses inherent in the loan and lease portfolio, which is based upon management’s estimate of those losses. The ALLL is established through a provision for loan and lease losses and is increased by provisions charged against current earnings and recoveries and reduced by charge-offs. Actual losses for loans and leases can vary significantly from this estimate. The methodology and assumptions used to calculate the allowance are continually reviewed as to their appropriateness given the most recent losses realized and other factors that influence the estimation process. The model assumptions and resulting allowance level are adjusted accordingly as these factors change.

The adequacy of the ALLL and the level of the related provision for loan and lease losses is determined based on management’s judgment after consideration of numerous factors including, but not limited to: (i) local and regional economic conditions, (ii) the financial condition of the borrowers, (iii) loan impairment and the related level of expected charge-offs, (iv) evaluation of industry trends, (v) industry and other concentrations, (vi) loans and leases which are contractually current as to payment terms but demonstrate a higher degree of risk as identified by management, (vii) continuing evaluations of the performing loan portfolio, (viii) ongoing review and evaluation of problem loans identified as having loss potential, (ix) quarterly review by the Board of Directors, and (x) assessments by banking regulators and other third parties. Management and the Board of Directors evaluate the ALLL and determine its appropriate level considering objective and subjective measures, such as knowledge of the borrower’s business, valuation of collateral, the determination of impaired loans or leases and exposure to potential losses.

The ALLL totaled $4,392,000 or 1.36% of total loans and leases at December 31, 2018, $4,478,000 or 1.43% of total loans and leases at December 31, 2017, and $4,822,000 or 1.47% at December 31, 2016. The decrease in the allowance for loan and lease losses from $4,478,000 at December 31, 2017 to $4,392,000 at December 31, 2018, was mainly due to a decrease in historical losses impacting the loss factor used in calculating the reserve on loans collectively valued for impairment and a reduction in the valuation allowances held for impaired loans. The Company establishes general and specific reserves in accordance with accounting principles generally accepted in the United States of America. The ALLL is composed of categories of the loan and lease portfolio based on loan type and loan rating; however, the entire allowance is available to cover actual loan and lease losses. While management uses available information to recognize possible losses on loans and leases, future additions to the allowance may be necessary, based on changes in economic conditions and other matters. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Company’s ALLL. Such agencies may require the Company to provide additions to the allowance based on their judgment of information available to them at the time of their examination.

The allowance for loans and leases was 162.7 times the nonperforming loans and leases at December 31, 2018 compared to 2.4 times the nonperforming loans and leases at December 31, 2017. The allowance for loans and leases as a percentage of impaired loans and leases was 50.5% at December 31, 2018 and 32.6% at December 31, 2017. Of the total nonperforming and impaired loans and leases outstanding as of December 31, 2018, there were $822,000 in loans or leases that had been reduced by partial charge-offs of $400,000.

At December 31, 2018, there was $5,968,000 in impaired loans or leases that did not carry a specific reserve. Of this amount, $493,000 were loans or leases that had previous partial charge-offs and $5,475,000 were loans or leases that were analyzed and determined not to require a specific reserve or charge-off because the collateral value or discounted cash flow value exceeded the loan or lease balance. Prior to 2013, the Company had been operating in a market that had experienced significant decreases in real estate values of commercial, residential, land, and construction properties. As such, the Company continues to focus on monitoring collateral values for those loans considered collateral dependent. The collateral evaluations performed by the Company are updated as necessary, which is generally once every twelve months, and are reviewed by a qualified credit officer.

The Company’s policy with regard to loan or lease charge-offs continues to be that a loan or lease is charged off against the ALLL when management believes that the collectability of the principal is unlikely. As previously discussed in the “Impaired Loans and Leases” section, certain loans are evaluated for impairment. Generally, if a loan is collateralized by real estate, and considered collateral dependent, the impaired portion will be charged off to the allowance for loan and lease losses unless it is in the process of collection, in which case a specific reserve may be warranted. If the collateral is other than real estate and considered impaired, a specific reserve may be warranted.

It is the policy of management to maintain the allowance for loan and lease losses at a level believed to be adequate for known and inherent risks in the portfolio. 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. Formula allocations are calculated by applying historical loss factors to outstanding loans with similar characteristics. Historical loss factors are based upon the Company's loss experience. These historical loss factors are adjusted for changes in the business cycle and for significant factors that, in management's judgment, affect the collectability of the loan portfolio as of the evaluation date. The discretionary allocation is based upon management's evaluation of various loan segment conditions that are not directly measured in the determination of the formula and specific allowances. The conditions may include, but are not limited to, general economic and business conditions affecting the key lending areas of the Company, credit quality trends, collateral values, loan volumes and concentrations, and other business conditions. Based on information currently available, management believes that the allowance for loan and lease losses is prudent and adequate. However, no prediction of the ultimate level of loans and leases charged off in future periods can be made with any certainty. Table Nine below summarizes, for the periods indicated, the activity in the ALLL.

Table Nine: Allowance for Loan and Lease Losses

	Year Ended December 31,				
(dollars in thousands)	2018	2017	2016	2015	2014
Average loans and leases outstanding	$308,365	$319,631	$306,737	$279,728	$253,898
Allowance for loan & lease losses at beginning of period	$4,478	$4,822	$4,975	$5,301	$5,346
Loans and leases charged off:					
Commercial	213	1,073	—	609	—
Real estate	—	—	93	—	—
Consumer	69	—	34	6	76
Lease financing receivable	—	—	—	1	—
Total	282	1,073	127	616	76
Recoveries of loans and leases previously charged off:					
Commercial	12	6	660	123	256
Real estate	8	228	534	165	163
Consumer	—	4	124	2	150
Lease financing receivable	1	41	—	—	3
Total	21	279	1,318	290	572
Net loans and leases charged off (recovered)	261	794	(1,191)	326	(496)
Additions (reductions) to allowance charged (credited) to operating expenses	175	450	(1,344)	—	(541)
Allowance for loan and lease losses at end of period	$4,392	$4,478	$4,822	$4,975	$5,301
Ratio of net charge-offs (recoveries) to average loans and leases outstanding	0.08%	0.25%	(0.39%)	0.12%	(0.20%)
Provision for loan and lease losses to average loans and leases outstanding	0.06%	0.14%	(0.44%)	—	(0.21%)
Allowance for loan and lease losses to total loans and leases, at end of period	1.36%	1.43%	1.47%	1.69%	2.01%

Allowance for loan and lease losses to nonperforming loans and leases, at end of period	16,266.67%	236.68 %	25,378.95%	302.80 %	320.69 %

As part of its loan review process, management has allocated the overall allowance based on specific identified problem loans and leases, qualitative factors, uncertainty inherent in the estimation process and historical loss data. A risk exists that future losses cannot be precisely quantified or attributed to particular loans or leases or classes of loans and leases. Management continues to evaluate the loan and lease portfolio and assesses current economic conditions that will affect management's conclusion as to future allowance levels. Table Ten below summarizes the allocation of the allowance for loan and lease losses for the five years ended December 31, 2018.

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Table Ten: Allowance for Loan and Lease Losses by Loan Category

(dollars in thousands)	December 31, 2018			December 31, 2017			December 31, 2016		
	Amount	Percent of loans in each category to total loans		Amount	Percent of loans in each category to total loans		Amount	Percent of loans in each category to total loans	
Commercial	$668	9	%	$447	8	%	$855	12	%
Real estate	3,165	87	%	3,695	91	%	3,600	86	%
Agriculture	88	1	%	31	1	%	64	1	%
Consumer	192	3	%	14	—		24	1	%
Lease financing receivable	—	—		—	—		1	—	
Unallocated	279	—		291	—		278	—	
Total	$4,392	100	%	$4,478	100	%	$4,822	100	%

	December 31, 2015			December 31, 2014		
	Amount	Percent of loans in each category to total loans		Amount	Percent of loans in each category to total loans	
Commercial	$860	12	%	$1,430	10	%
Real estate	3,729	86	%	3,429	86	%
Agriculture	77	1	%	62	1	%
Consumer	78	1	%	124	2	%
Lease financing receivable	1	—		2	1	%
Unallocated	230	—		254	—	
Total	$4,975	100	%	$5,301	100	%

The allocation presented should not be interpreted as an indication that charges to the allowance for loan and lease losses will be incurred in these amounts or proportions, or that the portion of the allowance allocated to each loan and lease category represents the total amounts available for charge-offs that may occur within these categories.

Other Real Estate Owned

The balance in OREO at December 31, 2018 and 2017 consisted of one property acquired through foreclosure. During 2018, the Company received and updated appraisal on the one property and reduced the balance by $4,000 through a charge to expense. During 2018, the Company did not acquire any OREO properties. There was $957,000 in OREO at December 31, 2018 with no valuation allowance and $961,000 in OREO at December 31, 2017 with no valuation allowance.

Deposits

At December 31, 2018, total deposits were $590,674,000 representing an increase of $34,594,000 (6.2%) from the December 31, 2017 balance of $556,080,000. The Company's deposit growth plan for 2018 was to concentrate its efforts on increasing noninterest-bearing demand, interest-bearing money market and interest-bearing checking, and savings accounts, while continuing to focus on reducing overall interest expense. Due to these efforts, the Company experienced increases during 2018 in interest-bearing checking ($4,780,000 or 7.4%), money market ($15,799,000 or 12.2%), savings ($6,392,000 or 9.7%), and time deposit ($8,406,000 or 10.5%) and decreases in noninterest-bearing demand ($783,000 or 0.4%) accounts.

Other Borrowed Funds

Other borrowings outstanding as of December 31, 2018 consist of advances from the Federal Home Loan Bank (the "FHLB"). The following table summarizes these borrowings (dollars in thousands):

	2018		2017		2016	
	Amount	Rate	Amount	Rate	Amount	Rate
Short-term borrowings: FHLB advances	$5,000	1.32%	$3,500	1.39%	$3,500	1.01%
Long-term borrowings: FHLB advances	$10,500	2.02%	$12,000	1.41%	$12,000	1.24%

The maximum amount of short-term borrowings at any month-end during 2018, 2017 and 2016, was $6,500,000, $3,500,000, and $25,500,000, respectively. The FHLB advances are collateralized by loans and securities pledged to the FHLB. The following is a breakdown of rates and maturities on FHLB advances (dollars in thousands):

	Short-term	Long-term
Amount	$ 5,000	$10,500
Maturity	2019	2020 to 2023
Average rates	1.32 %	2.02 %

The Company has the ability to enter into letters of credit with the FHLB. There were no letters of credit outstanding as of December 31, 2018 or 2017. There were no amounts drawn upon any letter of credit in 2018 or 2017 and management does not expect to draw upon these sources of liquidity in the foreseeable future.

Capital Resources

The current and projected capital position of the Company and the impact of capital plans and long-term strategies are reviewed regularly by management. The Company's capital position represents the level of capital available to support continuing operations and expansion.

On January 25, 2017, the Company approved and authorized a stock repurchase program for 2017 (the "2017 Program"). The 2017 Program authorized the repurchase during 2017 of up to 5% of the outstanding shares of the Company's common stock. In addition, on October 18, 2017, the Company approved and authorized an additional amount of 5% to be purchased under the 2017 Program. During 2017, the Company repurchased 574,748 shares of its common stock at an average price of $14.99 per share. On January 24, 2018, the Company approved and authorized a stock repurchase program for 2018 (the "2018 Program"). The 2018 Program authorized the repurchase during 2018 of up to 5% of the outstanding shares of the Company's common stock. During 2018, the Company repurchased 308,618 shares of its common stock at an average price of $15.52 per share.

The Company did not repurchase any shares in 2011 or 2010 and repurchased 575,389 shares in 2012, 849,404 shares in 2013, 424,462 in 2014, 790,989 shares in 2015, and 716,897 shares in 2016. Share amounts have been adjusted for stock dividends and/or splits. See Part II, Item 5, "Stock Repurchases" for more information regarding stock repurchases.

The Company and American River Bank are subject to certain regulatory capital requirements administered by the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation. Failure to meet these minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Company’s consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, banks must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The Company’s and American River Bank’s capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors. As of December 31, 2018 and 2017, the most recent regulatory notification categorized American River Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the Bank’s categories.

At December 31, 2018, shareholders' equity was $74,721,000, representing a decrease of $2,200,000 (2.9%) from $76,921,000 at December 31, 2017. The decrease in 2018 resulted from repurchases of common stock of $4,773,000, the payment of cash dividends of $1,188,000, and a decrease in other comprehensive income of $1,555,000, as a result of the decrease in the unrealized gain on securities due to an increase in interest rates, exceeding the additions from net income of $4,900,000 for the period and the stock based compensation of $416,000. In 2017, shareholders' equity decreased $6,929,000 (8.2%) from $83,850,000 at December 31, 2016. The decrease in 2017 resulted from the reductions in other comprehensive income, payment of cash dividends, and repurchases of common stock exceeding the additions from net income for the period and the increase in stock based compensation expense.

Table Eleven below lists the Company's and American River Bank's actual capital ratios at December 31, 2018 and 2017, as well as the minimum capital ratios for capital adequacy for American River Bank. The ratio for the minimum regulatory requirement includes the capital conservation buffer of 1.875% as of December 31, 2018 and 1.25% as of December 31, 2017.

Table Eleven: Capital Ratios

	At December 31,				Minimum Regulatory Capital Requirements			
	2018		2017		2018		2017	
American River Bankshares:								
Leverage ratio	8.9	%	9.5	%	N/A		N/A	
Tier 1 Risk-Based Capital	16.1	%	18.1	%	N/A		N/A	
Total Risk-Based Capital	17.3	%	19.3	%	N/A		N/A	
American River Bank:								
Leverage ratio	9.0	%	9.3	%	5.9	%	5.3	%
Common Equity Tier 1 Capital	16.2	%	17.7	%	6.4	%	5.8	%
Tier 1 Risk-Based Capital	16.2	%	17.7	%	7.9	%	7.3	%
Total Risk-Based Capital	17.4	%	19.0	%	9.9	%	9.3	%

Capital ratios are reviewed on a regular basis to ensure that capital exceeds the prescribed regulatory minimums and is adequate to meet future needs. At December 31, 2018, American River Bank's ratios were in excess of the regulatory definition of "well capitalized." Management believes that the Company's capital is adequate to support current operations and anticipated growth and currently foreseeable future capital requirements of the Company and its subsidiaries.

Effective January 1, 2015, bank holding companies with consolidated assets of $1 Billion or more ($3 Billion or more effective August 30, 2018) and banks like American River Bank must comply with new minimum capital ratio requirements to be phased-in between January 1, 2015 and January 1, 2019, which consist of the following: (i) a new common equity Tier 1 capital to total risk weighted assets ratio of 4.5%; (ii) a Tier 1 capital to total risk weighted assets ratio of 6%; (iii) a total capital to total risk weighted assets ratio of 8%; and (iv) a Tier 1 capital to adjusted average total assets ("leverage") ratio of 4%.

In addition, a "capital conservation buffer," is established which when fully phased-in will require maintenance of a minimum of 2.5% of common equity Tier 1 capital to total risk weighted assets in excess of the regulatory minimum capital ratio requirements described above. The 2.5% buffer will increase the minimum capital ratios to (i) a common equity Tier 1 capital ratio of 7.0%, (ii) a Tier 1 capital ratio of 8.5%, and (iii) a total capital ratio of 10.5%. The new buffer requirement will be phased-in between January 1, 2016 and January 1, 2019. The buffer requirement for 2018 was 1.875% and became fully phased in on January 1, 2019, increasing to 2.50%. If the capital ratio levels of a banking organization fall below the capital conservation buffer amount, the organization will be subject to limitations on (i) the payment of dividends; (ii) discretionary bonus payments; (iii) discretionary payments under Tier 1 instruments; and (iv) engaging in share repurchases.

Market Risk Management

Overview. Market risk is the risk of loss from adverse changes in market prices and rates. The Company's market risk arises primarily from interest rate risk inherent in its loan, investment and deposit functions. The goal for managing the assets and liabilities of the Company is to maximize shareholder value and earnings while maintaining a high quality balance sheet without exposing the Company to undue interest rate risk. The Board of Directors has overall responsibility for the interest rate risk management policies. The Company has an Enterprise Risk Management Committee, made up of Company management that establishes and monitors guidelines to control the sensitivity of earnings to changes in interest rates.

Asset/Liability Management. Activities involved in asset/liability management include but are not limited to lending, accepting and placing deposits and investing in securities. Interest rate risk is the primary market risk associated with asset/liability management. Sensitivity of earnings to interest rate changes arises when yields on assets change in a different time period or in a different amount from that of interest costs on liabilities. To mitigate interest rate risk, the structure of the balance sheet is managed with the goal that movements of interest rates on assets and liabilities are correlated and contribute to earnings even in periods of volatile interest rates. The asset/liability management policy sets limits on the acceptable amount of variance in net interest margin and market value of equity under changing interest environments. The Company uses simulation models to forecast earnings, net interest margin and market value of equity.

Simulation of earnings is the primary tool used to measure the sensitivity of earnings to interest rate changes. Using computer-modeling techniques, with specialized software built for this specific purpose for financial institutions, the Company is able to estimate the potential impact of changing interest rates on earnings, net interest margin and market value of equity. A balance sheet is prepared using detailed inputs of actual loans, securities and interest-bearing liabilities (i.e. deposits/borrowings). The balance sheet is processed using multiple interest rate scenarios. The scenarios include a rising rate forecast, a flat rate forecast and a falling rate forecast which take place within a one-year time frame. The net interest income is measured over one-year and two-year periods assuming a gradual change in rates over the twelve-month horizon. The simulation modeling attempts to estimate changes in the Company's net interest income utilizing a detailed current balance sheet. Table Twelve below summarizes the effect on net interest income (NII) of a ±100 and ±200 basis point change in interest rates as measured against a constant rate (no change) scenario.

Table Twelve: Interest Rate Risk Simulation of Net Interest as of December 31, 2018

(dollars in thousands)	$ Change in NII from Current 12 Month Horizon	$ Change in NII from Current 24 Month Horizon
Variation from a constant rate scenario		
+100bp	$ 195	$ 591
+200bp	$ 349	$ 1,042
-100bp	$ (605)	$ (1,550)
-200bp	$ (1,154)	$ (3,211)

After a review of the model results as of December 31, 2018, the Company does not consider the fluctuations from the base case, to have a material impact on the Company's projected results and are within the tolerance levels outlined in the Company's interest rate risk polices. The simulations of earnings do not incorporate any management actions, which might moderate the negative consequences of interest rate deviations. Therefore, they do not reflect likely actual results, but serve as reasonable estimates of interest rate risk.

Interest Rate Sensitivity Analysis

Interest rate sensitivity is a function of the repricing characteristics of the portfolio of assets and liabilities. These repricing characteristics are the time frames within which the interest-bearing assets and liabilities are subject to change in interest rates either at replacement, repricing or maturity. Interest rate sensitivity management focuses on the maturity of assets and liabilities and their repricing during periods of changes in market interest rates. Interest rate sensitivity is measured as the difference between the volumes of assets and liabilities in the current portfolio that are subject to repricing at various time horizons. The differences are known as interest sensitivity gaps. A positive cumulative gap may be equated to an asset sensitive position. An asset sensitive position in a rising interest rate environment will cause a bank's interest rate margin to expand. This results as floating or variable rate loans reprice more rapidly than fixed rate certificates of deposit that reprice as they mature over time. Conversely, a declining interest rate environment will cause the opposite effect. A negative cumulative gap may be equated to a liability sensitive position. A liability sensitive position in a rising interest rate environment will cause a bank's interest rate margin to contract, while a declining interest rate environment will have the opposite effect.

Inflation

The impact of inflation on a financial institution differs significantly from that exerted on manufacturing, or other commercial concerns, primarily because its assets and liabilities are largely monetary. In general, inflation primarily affects the Company through its effect on market rates of interest, which affects the Company’s ability to attract loan customers. Inflation affects the growth of total assets by increasing the level of loan demand, and potentially adversely affects capital adequacy because loan growth in inflationary periods can increase at rates higher than the rate that capital grows through retention of earnings which may be generated in the future. In addition to its effects on interest rates, inflation increases overall operating expenses. Inflation has not had a material effect upon the results of operations of the Company during the years ended December 31, 2018, 2017 and 2016.

Liquidity

Liquidity management refers to the Company’s ability to provide funds on an ongoing basis to meet fluctuations in deposit levels as well as the credit needs and requirements of its clients. Both assets and liabilities contribute to the Company’s liquidity position. Federal funds lines, short-term investments and securities, and loan and lease repayments contribute to liquidity, along with deposit increases, while loan and lease funding and deposit withdrawals decrease liquidity. The Company assesses the likelihood of projected funding requirements by reviewing historical funding patterns, current and forecasted economic conditions and individual client funding needs. Commitments to fund loans and outstanding standby letters of credit at December 31, 2018 were approximately $34,276,000 and $361,000, respectively. Such loan commitments relate primarily to revolving lines of credit and other commercial loans and to real estate construction loans. Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

The Company’s sources of liquidity consist of cash and due from correspondent banks, overnight funds sold to correspondent banks, unpledged marketable investments and loans held for sale. On December 31, 2018, consolidated liquid assets totaled $226.5 million or 32.9% of total assets compared to $226.3 million or 34.5% of total assets on December 31, 2017. In addition to liquid assets, the Company maintains short-term lines of credit in the amount of $17,000,000 with two of its correspondent banks. At December 31, 2018, the Company had $17,000,000 available under these credit lines. Additionally, American River Bank is a member of the FHLB. At December 31, 2018, American River Bank could have arranged for up to $122,762,000 in secured borrowings from the FHLB. These borrowings are secured by pledged mortgage loans and investment securities. At December 31, 2018, the Company had $107,262,000 available under these secured borrowing arrangements. American River Bank also has a secured borrowing arrangement with the Federal Reserve Bank. The borrowing can be secured by pledging selected loans and investment securities. Based on the amount of assets pledged at the Federal Reserve Bank at December 31, 2018, the Company’s borrowing capacity was $8,340,000.

The Company serves primarily a business and professional customer base and, as such, its deposit base is susceptible to economic fluctuations. Accordingly, management strives to maintain a balanced position of liquid assets to volatile and cyclical deposits.

Liquidity is also affected by portfolio maturities and the effect of interest rate fluctuations on the marketability of both assets and liabilities. The Company can sell any of its unpledged securities held in the available-for-sale category to meet liquidity needs. These securities are also available to pledge as collateral for borrowings if the need should arise. American River Bank can also pledge additional securities to borrow from the Federal Reserve Bank and the FHLB.

The maturity distribution of certificates of deposit is set forth in Table Thirteen below for the period presented. These deposits are generally more rate sensitive than other deposits and, therefore, are more likely to be withdrawn to obtain higher yields elsewhere if available.

Table Thirteen: Certificates of Deposit Maturities

December 31, 2018	Less than	Over
(dollars in thousands)	$250,000	$250,000
Three months or less	$ 7,965	$ 5,054
Over three months through six months	4,831	26,329
Over six months through twelve months	5,691	15,046
Over twelve months	12,572	10,599
Total	$ 31,059	$ 57,028

Loan and lease demand also affects the Company's liquidity position. Table Fourteen below presents the maturities of loans and leases for the period indicated.

Table Fourteen: Loan and Lease Maturities (Gross Loans and Leases)

December 31, 2018	One year	One year through	Over	
(dollars in thousands)	or less	five years	five years	Total
Commercial	$ 4,019	$ 10,970	$ 14,661	$ 29,650
Real estate	19,445	82,443	176,168	278,056
Agriculture	17	907	3,495	4,419
Consumer	1	321	10,392	10,714
Leases	32	—	—	32
Total	$ 23,514	$ 94,641	$ 204,716	$ 322,871

Loans and leases shown above with maturities greater than one year include $185,731,000 of variable interest rate loans and $113,626,000 of fixed interest rate loans and leases. The carrying amount, maturity distribution and weighted average yield of the Company's investment securities available-for-sale and held-to-maturity portfolios are presented in Table Fifteen below. The yields on tax-exempt obligations have been computed on a tax equivalent basis. Yields may not represent actual future income to be recorded. Timing of principal prepayments on mortgage-backed securities may increase or decrease depending on market factors and the borrowers' ability to make unscheduled principal payments. Fast prepayments on bonds that were purchased with a premium will result in a lower yield and slower prepayments on premium bonds will result in a higher yield, the opposite would be true for bonds purchased at a discount. Table Fifteen does not include FHLB Stock, which does not have stated maturity dates or readily available market values. The balance in FHLB Stock at December 31, 2018, 2017 and 2016 was $3,932,000, $3,932,000 and $3,779,000, respectively.

Table Fifteen: Securities Maturities and Weighted Average Yields

(Taxable Equivalent Basis)

December 31, (dollars in thousands)	2018 Carrying Amount	Weighted Average Yield		2017 Carrying Amount	Weighted Average Yield		2016 Carrying Amount	Weighted Average Yield	
Available-for-sale securities:									
State and political subdivisions									
Maturing within 1 year	$255	5.06	%	$—	—		$580	5.39	%
Maturing after 1 year but within 5 years	1,141	5.06	%	3,018	2.23	%	2,328	4.35	%
Maturing after 5 years but within 10 years	9,831	6.03	%	14,389	4.42	%	14,486	4.36	%
Maturing after 10 years	3,173	6.33	%	5,307	4.11	%	5,218	3.23	%
U.S Treasury securities									
Maturing within 1 year	4,976	2.30	%	—	—		—	—	
U.S. Government Agencies and U.S.-Sponsored Agencies	269,049	2.69	%	232,869	2.10	%	229,785	2.04	%
Other									
Maturing after 1 year but within 5 years	2,434	2.49	%	2,469	2.72	%	1,519	4.88	%
Maturing after 5 years but within 10 years	4,074	5.53	%	4,158	4.56	%	1,519	4.88	%
Non-maturing	—	—		112	0.00	%	104	0.00	%
Total investment securities	$294,933	2.88	%	$262,322	2.32	%	$254,020	2.35	%
Held-to-maturity securities:									
U.S. Government Agencies and U.S.-Sponsored Agencies	$292	5.40	%	$378	5.46	%	$483	5.43	%
Total investment securities	$292	5.40	%	$378	5.46	%	$483	5.43	%

The carrying values of available-for-sale securities include net unrealized (losses) gains of ($2,664,000), ($456,000) and $916,000 at December 31, 2018, 2017 and 2016, respectively. The carrying values of held-to-maturity securities do not include unrealized gains or losses; however, the net unrecognized gains at December 31, 2018, 2017 and 2016 were $14,000, $26,000 and $38,000, respectively.

Off-Balance Sheet Arrangements

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business in order to meet the financing needs of its customers and to reduce its exposure to fluctuations in interest rates. These financial instruments consist of commitments to extend credit and letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized on the balance sheet.

As of December 31, 2018, commitments to extend credit and letters of credit were the only financial instruments with off-balance sheet risk. The Company has not entered into any contracts for financial derivative instruments such as futures, swaps, options or similar instruments. At origination, real estate commitments are generally secured by property with a loan-to-value ratio of 55% to 75%. In addition, the majority of the Company’s commitments have variable interest rates. The following financial instruments represent off-balance-sheet credit risk:

	December 31, 2018	2017
Commitments to extend credit (dollars in thousands):		
Revolving lines of credit secured by 1-4 family residences	$47	$175
Commercial real estate, construction and land development commitments secured by real estate	21,185	3,565
Other unused commitments, principally commercial loans	13,044	7,183
	$34,276	$10,923
Letters of credit	$361	$121

The Company's exposure to credit loss in the event of nonperformance by the other party 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 letters of credit as it does for loans included on the consolidated balance sheets.

Certain financial institutions have elected to use special purpose vehicles ("SPV") to dispose of problem assets. The SPV is typically a subsidiary company with an asset and liability structure and legal status that makes its obligations secure even if the parent corporation goes bankrupt. Under certain circumstances, these financial institutions may exclude the problem assets from their reported impaired and nonperforming assets. The Company does not use those vehicles or any other structures to dispose of problem assets.

Contractual Obligations

The Company leases certain facilities at which it conducts its operations. Future minimum lease commitments under non-cancelable operating leases are noted in Table Sixteen below. Table Sixteen below presents certain of the Company's contractual obligations as of December 31, 2018.

Table Sixteen: Contractual Obligations

		Payments due by period			
(dollars in thousands)	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Long-Term Debt	$15,500	$ 5,000	$7,000	$3,500	$—
Capital Lease Obligations	—	—	—	—	—
Operating Leases	3,940	747	1,348	915	930
Purchase Obligations	—	—	—	—	—
Certificates of Deposit	88,087	64,916	14,439	8,732	—
Other Long-Term Liabilities Reflected on the Company's Balance Sheet under GAAP	4,612	370	784	789	2,669
Total	$112,139	$ 71,033	$23,571	$13,936	$3,599

Included in the table are amounts payable under the Company's Deferred Compensation Plan, Deferred Fees Plan and salary continuation agreements listed in the "Other Long-Term Liabilities…" category. At December 31, 2018, these amounts represented $4,612,000 most of which is anticipated to be primarily payable at least five years in the future.

Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (the "FASB") and the International Accounting Standards Board (the "IASB") jointly issued a comprehensive new revenue recognition standard that supersedes nearly all existing revenue recognition guidance under GAAP and International Financial Reporting Standards ("IFRS"). Previous revenue recognition guidance in GAAP consisted of broad revenue recognition concepts together with numerous revenue requirements for particular industries or transactions, which sometimes resulted in different accounting for economically similar transactions. In contrast, IFRS provided limited revenue recognition guidance and, consequently, could be difficult to apply to complex transactions. Accordingly, the FASB and the IASB initiated a joint project to clarify the principles for recognizing revenue and to develop a common revenue standard for U.S. GAAP and IFRS that: (1) removes inconsistencies and weaknesses in revenue requirements; (2) provides a more robust framework for addressing revenue issues; (3) improves comparability of revenue recognition practices across entities, industries, jurisdictions, and capital markets; (4) provides more useful information to users of financial statements through improved disclosure requirements; and (5) simplifies the preparation of financial statements by reducing the number of requirements to which an entity must refer. To meet those objectives, the FASB issued Accounting Standards Update ("ASU") No. 2014-09, "*Revenue from Contracts with Customers.*" The standard's core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. In doing so, companies generally will be required to use more judgment and make more estimates than under current guidance. These may include identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. The standard was initially effective for public entities for interim and annual reporting periods beginning after December 15, 2016; early adoption was not permitted. However, in August 2015, the FASB issued ASU No. 2015-14, "*Revenue from Contracts with Customers - Deferral of the Effective Date*" which deferred the effective date by one year (i.e., interim and annual reporting periods beginning after December 15, 2017). For financial reporting purposes, the standard allows for either full retrospective adoption, meaning the standard is applied to all of the periods presented, or modified retrospective adoption, meaning the standard is applied only to the most current period presented in the financial statements with the cumulative effect of initially applying the standard recognized at the date of initial application. In addition, the FASB issued targeted updates to clarify specific implementation issues of ASU 2014- 09. These updates include ASU No. 2016-08, "*Principal versus Agent Considerations (Reporting Revenue Gross versus Net),*" ASU No. 2016-10, "*Identifying Performance Obligations and Licensing,*" ASU No. 2016-12, "*Narrow-Scope Improvements and Practical Expedients,*" and ASU No. 2016-20 "*Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers.*" The Company has assessed its revenue streams and reviewed its contracts that could potentially be affected by the ASU including deposit related fees, interchange fees, and merchant income, to determine the impact the new guidance has on the Company's financial position, results of operations or cash flows. The Company adopted ASU No. 2014-09 on January 1, 2018. The effects of adopting ASU No. 2014-09 did not change the amounts of revenue recorded for the Company's in-scope revenue streams.

In January 2016, the FASB issued ASU No. 2016-01, "*Recognition and Measurement of Financial Assets and Financial Liabilities.*" This ASU addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments by making targeted improvements to GAAP as follows: (1) require equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. However, an entity may choose to measure equity investments that do not have readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer; (2) simplify the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment. When a qualitative assessment indicates that impairment exists, an entity is required to measure the investment at fair value; (3) eliminate the requirement to disclose the fair value of financial instruments measured at amortized cost for entities that are not public business entities; (4) eliminate the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; (5) require public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; (6) require an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments; (7) require separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements; and (8) clarify that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets. ASU No. 2016-01 is effective for interim and annual reporting periods beginning after December 15, 2017. Early application was permitted as of the beginning of the fiscal year of adoption only for provisions (3) and (6) above. Early adoption of the other provisions mentioned above were not permitted. The Company adopted ASU No. 2016-01 on January 1, 2018. The effects of adopting ASU No. 2016-01 resulted in the Company using the exit price notion for valuing financial instruments in 2018, but did not have a material impact on the Company's financial position, results of operations or cash flows.

In February 2016, the FASB issued ASU No. 2016-02, "*Leases.*" Under the new guidance, lessees will be required to recognize the following for all leases (with the exception of short-term leases): 1) a lease liability, which is the present value of a lessee's obligation to make lease payments, and 2) a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Lessor accounting under the new guidance remains largely unchanged as it is substantially equivalent to existing guidance for sales-type leases, direct financing leases, and operating leases. Leveraged leases have been eliminated, although lessors can continue to account for existing leveraged leases using the current accounting guidance. Other limited changes were made to align lessor accounting with the lessee accounting model and the new revenue recognition standard. All entities will classify leases to determine how to recognize lease-related revenue and expense. Quantitative and qualitative disclosures will be required by lessees and lessors to meet the objective of enabling users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases. The intention is to require enough information to supplement the amounts recorded in the financial statements so that users can understand more about the nature of an entity's leasing activities. ASU No. 2016-02 was effective for interim and annual reporting periods beginning after December 15, 2018; early adoption was permitted. All entities are required to use a modified retrospective approach for leases that exist or are entered into after the beginning of the earliest comparative period in the financial statements. They have the option to use certain relief; full retrospective application is prohibited. Based on evaluation of the Company's current lease obligations, the Company has determined that the provisions of ASU No. 2016-02 resulted in an increase in assets to recognize the present value of the lease obligations with a corresponding increase in liabilities. The Company currently leases nine of its office leases under operating leases. The Company adopted ASU No. 2016-02 on January 1, 2019. The Company's present value of future lease payments as of January 1, 2019 is $3,570,000, to be recorded as a right-of-use asset with an offsetting liability. The effects of adopting ASU No. 2016-02 did not have a material impact on the Company's financial position, results of operations or cash flows.

In June 2016, the FASB issued ASU No. 2016-13, "*Measurement of Credit Losses on Financial Instruments.*" This ASU significantly changes how entities will measure credit losses for most financial assets and certain other instruments that aren't measured at fair value through net income. In issuing the standard, the FASB is responding to criticism that today's guidance delays recognition of credit losses. The standard will replace today's "incurred loss" approach with an "expected loss" model. The new model, referred to as the current expected credit loss ("CECL") model, will apply to: (1) financial assets subject to credit losses and measured at amortized cost, and (2) certain off-balance sheet credit exposures. This includes, but is not limited to, loans, leases, held-to-maturity securities, loan commitments, and financial guarantees. The CECL model does not apply to available-for-sale ("AFS") debt securities. For AFS debt securities with unrealized losses, entities will measure credit losses in a manner similar to what they do today, except that the losses will be recognized as allowances rather than reductions in the amortized cost of the securities. As a result, entities will recognize improvements to estimated credit losses immediately in earnings rather than as interest income over time, as they do today. The ASU also simplifies the accounting model for purchased credit-impaired debt securities and loans. ASU 2016-13 also expands the disclosure requirements regarding an entity's assumptions, models, and methods for estimating the allowance for loan and lease losses. In addition, entities will need to disclose the amortized cost balance for each class of financial asset by credit quality indicator, disaggregated by the year of origination. ASU No. 2016-13 is effective for interim and annual reporting periods beginning after December 15, 2019; early adoption is permitted for interim and annual reporting periods beginning after December 15, 2018. Entities will apply the standard's provisions as a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective (i.e., modified retrospective approach). While the Company is currently evaluating the provisions of ASU No. 2016-13 to determine the potential impact the new standard will have on the Company's Consolidated Financial Statements, it has taken steps to prepare for the implementation when it becomes effective, such as forming an internal task force, gathering pertinent data, consulting with outside professionals, evaluating its current IT systems, and purchasing a software solution. The Company intends to begin processing information with the new CECL specific software during the first part of 2019 and to disclose any potential impact of this modeling once it becomes available.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

The information required by Item 7A of Form 10-K is contained in the “Market Risk Management” section of Item 7-“Management’s Discussion and Analysis of Financial Condition and Results of Operations” on page 48.

Item 8. Financial Statements and Supplementary Data.

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All schedules have been omitted since the required information is not present in amounts sufficient to require submission of the schedule or because the information required is included in the Consolidated Financial Statements or notes thereto.

Crowe LLP
Independent Member Crowe Global

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Shareholders and Board of Directors

American River Bankshares

Rancho Cordova, California

Opinions on the Financial Statements and Internal Control over Financial Reporting

We have audited the accompanying consolidated balance sheets of American River Bankshares and Subsidiaries (the "Company") as of December 31, 2018 and 2017, the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2018, and the related notes (collectively referred to as the "financial statements"). We also have audited the Company's internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control – Integrated Framework: (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2018 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control – Integrated Framework: (2013) issued by COSO.

Basis for Opinions

The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Report of Management on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company’s financial statements and an opinion on the Company’s internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (“PCAOB”) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the financial statements included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

Definition and Limitations of Internal Control over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ Crowe LLP

Crowe LLP

We have served as the Company's auditor since 2011.

Sacramento, California

February 21, 2019

AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

December 31, 2018 and 2017

(Dollars in thousands)

	2018	2017
ASSETS		
Cash and due from banks	$20,987	$38,467
Federal funds sold	7,000	—
Total cash and cash equivalents	27,987	38,467
Interest-bearing deposits in banks	1,746	1,746
Investment securities (Note 5):		
Available-for-sale, at fair value	294,933	262,322
Held-to-maturity, at amortized cost; fair value of $306 in 2018 and $404 in 2017	292	378
Loans and leases, less allowance for loan and lease losses of $4,392 in 2018 and $4,478 in 2017 (Notes 6, 7, 12 and 17)	318,516	308,713
Premises and equipment, net (Note 8)	1,071	1,158
Federal Home Loan Bank of San Francisco stock	3,932	3,932
Other real estate owned, net	957	961
Goodwill (Note 4)	16,321	16,321
Bank-owned life insurance (Note 16)	15,429	15,122
Accrued interest receivable and other assets (Notes 11 and 16)	6,908	6,502
	$688,092	$655,622
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Noninterest-bearing	$214,745	$215,528
Interest-bearing (Note 9)	375,929	340,552
Total deposits	590,674	556,080
Short-term borrowings (Note 10)	5,000	3,500
Long-term borrowings (Note 10)	10,500	12,000
Accrued interest payable and other liabilities (Note 16)	7,197	7,121
Total liabilities	613,371	578,701

Commitments and contingencies (Note 12)		
Shareholders' equity (Notes 13 and 14):		
Common stock - no par value; 20,000,000 shares authorized; issued and outstanding – 5,858,428 shares in 2018 and 6,132,362 shares in 2017	30,103	34,463
Retained earnings	46,494	42,779
Accumulated other comprehensive loss, net of taxes (Note 5)	(1,876)	(321)
Total shareholders' equity	74,721	76,921
	$688,092	$655,622

See accompanying notes to consolidated financial statements.

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AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

For the Years Ended December 31, 2018, 2017 and 2016

(Dollars in thousands, except per share data)

	2018	2017	2016
Interest income:			
Interest and fees on loans and leases:			
Taxable	$13,924	$13,947	$14,008
Exempt from Federal income taxes	529	499	723
Interest on deposits in banks	33	13	7
Interest on Federal funds sold	348	—	—
Interest and dividends on investment securities:			
Taxable	6,901	5,300	5,769
Exempt from Federal income taxes	507	655	646
Total interest income	22,242	20,414	21,153
Interest expense:			
Interest on deposits (Note 9)	1,359	855	730
Interest on borrowings	237	206	180
Total interest expense	1,596	1,061	910
Net interest income	20,646	19,353	20,243
Provision for loan and lease losses (Note 7)	175	450	(1,344)
Net interest income after provision for loan and lease losses	20,471	18,903	21,587
Noninterest income:			
Service charges	476	465	502
Gain on sale of investment securities (Note 5)	31	161	314
Income from other real estate owned properties	—	—	279
Other income (Note 15)	1,006	970	950
Total noninterest income	1,513	1,596	2,045
Noninterest expense:			
Salaries and employee benefits (Notes 6 and 16)	10,203	8,920	8,435

Other real estate expense	20	44	246
Occupancy (Notes 8, 12 and 17)	1,050	1,053	1,175
Furniture and equipment (Notes 8 and 12)	553	586	652
Regulatory assessments	280	280	328
Other expense (Note 15)	3,404	3,166	3,000
Total noninterest expense	15,510	14,049	13,836
Income before provision for income taxes	6,474	6,450	9,796
Provision for income taxes (Note 11)	1,574	3,252	3,392
Net income	$4,900	$3,198	$6,404
Basic earnings per share (Note 13)	$0.83	$0.50	$0.95
Diluted earnings per share (Note 13)	$0.83	$0.50	$0.94

See accompanying notes to consolidated financial statements.

AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

For the Years Ended December 31, 2018, 2017 and 2016

(Dollars in thousands)

	2018	2017	2016
Net income	$4,900	$3,198	$6,404
Other comprehensive income:			
Decrease in net unrealized gains on investment securities	(2,225)	(1,211)	(2,274)
Deferred tax benefit	691	491	905
Decrease in net unrealized gains on investment securities, net of tax	(1,534)	(720)	(1,369)
Reclassification adjustment for realized gains included in net income	(31)	(161)	(314)
Tax effect	10	64	124
Realized gains, net of tax	(21)	(97)	(190)
Total other comprehensive (loss)	(1,555)	(817)	(1,559)
Comprehensive income	$3,345	$2,381	$4,845

See accompanying notes to consolidated financial statements.

AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

For the Years Ended December 31, 2018, 2017 and 2016

(Dollars in thousands)

	Common Stock		Retained	Accumulated Other Comprehensive Income (Loss) (Net of Taxes)	Total Shareholders'
	Shares	Amount	Earnings		Equity
Balance, January 1, 2016	7,343,649	$49,554	$34,418	$ 2,103	$ 86,075
Net income	—	—	6,404	—	6,404
Other comprehensive loss, net of tax (Note 5)	—	—	—	(1,559)	(1,559)
Retirement of common stock (Note 13)	(716,897)	(7,414)	—	—	(7,414)
Net restricted stock award activity and related compensation expense (Note 13)	33,474	291	—	—	291
Stock options exercised (Note 13)	1,500	13	—	—	13
Stock option compensation expense (Note 13)	—	40	—	—	40
Balance, December 31, 2016	6,661,726	42,484	40,822	544	83,850
Net income	—	—	3,198	—	3,198
Other comprehensive loss, net of tax (Note 5)	—	—	—	(817)	(817)
Disproportionate tax effect resulting from H.R.1 Tax Act (Note 2)	—	—	48	(48)	—
Payment of cash dividend, $0.20 per share (Note 14)	—	—	(1,293)	—	(1,293)
Retirement of common stock (Note 13)	(574,748)	(8,641)	—	—	(8,641)
Net restricted stock award activity and related compensation expense (Note 13)	3,486	248	4	—	252
Stock options exercised (Note 13)	41,898	351	—	—	351
Stock option compensation expense (Note 13)	—	21	—	—	21
Balance, December 31, 2017	6,132,362	34,463	42,779	(321)	76,921

Net income	—	—	4,900	—	4,900
Other comprehensive loss, net of tax (Note 5)	—	—	—	(1,555)	(1,555)
Payment of cash dividend, $0.20 per share (Note 14)	—	—	(1,188)	—	(1,188)
Retirement of common stock (Note 13)	(306,618)	(4,773)	—	—	(4,773)
Net restricted stock award activity and related compensation expense (Note 13)	11,374	196	3	—	199
Stock options exercised (Note 13)	21,310	189	—	—	189
Stock option compensation expense (Note 13)	—	28	—	—	28
Balance, December 31, 2018	5,858,428	$30,103	$46,494	$ (1,876)	$ 74,721

See accompanying notes to consolidated financial statements.

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AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Years Ended December 31, 2018, 2017 and 2016

(Dollars in thousands)

	2018	2017	2016
Cash flows from operating activities:			
Net income	$4,900	$3,198	$6,404
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan and lease losses	175	450	(1,344)
(Decrease) increase in deferred loan and lease origination fees, net	(239)	(20)	1
Depreciation and amortization	265	333	420
Amortization of investment security premiums and discounts, net	2,404	3,246	2,940
Gain on sale of investment securities	(31)	(161)	(314)
Increase in cash surrender value of life insurance policies	(307)	(317)	(322)
Deferred income tax expense (benefit)	333	1,247	(283)
Stock-based compensation expense	227	273	331
Loss (gain) on sale or write-down of other real estate owned	4	(8)	118
Fair value adjustment to acquired other real estate owned	—	—	(239)
(Increase) decrease in accrued interest receivable and other assets	(125)	(537)	1,734
Increase (decrease) in accrued interest payable and other liabilities	76	(173)	419
Net cash provided by operating activities	7,682	7,531	9,865
Cash flows from investing activities:			
Proceeds from the sale of available-for-sale investment securities	27,003	31,289	12,655
Proceeds from called available-for-sale investment securities	2,139	145	1,550
Proceeds from matured available-for-sale investment securities	—	1,930	1,100
Purchases of available-for-sale investment securities	(110,615)	(89,273)	(47,292)
Proceeds from principal repayments for available-for-sale mortgage-backed securities	44,321	43,150	46,570
Proceeds from principal repayments for held-to-maturity mortgage-backed securities	86	105	140
Net (increase) decrease in interest-bearing deposits in banks	—	(747)	(249)
Net (increase) decrease in loans and leases	(290)	14,944	(33,064)
Proceeds from sale of loans	1,349	—	—
Purchases of loans	(10,799)	—	—
Net proceeds from sale of other real estate owned	—	395	1,747
Purchases of equipment	(178)	(129)	(375)
Net increase in FHLB stock	—	(153)	—

Net cash (used in) provided by investing activities	(46,984)	1,656	(17,218)

See accompanying notes to consolidated financial statements.

AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Continued)

For the Years Ended December 31, 2018, 2017 and 2016

(Dollars in thousands)

	2018	2017	2016
Cash flows from financing activities:			
Net increase in demand, interest-bearing and savings deposits	$26,198	$14,552	$15,728
Net increase (decrease) in time deposits	8,396	(3,278)	(1,612)
Cash paid to repurchase common stock	(4,773)	(8,641)	(7,414)
Proceeds from exercised options	189	351	13
(Decrease) increase in long-term borrowings	(1,500)	—	4,500
Increase in long-term borrowings	1,500	—	—
Cash dividends paid	(1,188)	(1,293)	—
Net cash provided by financing activities	28,822	1,691	11,215
(Decrease) increase in cash and cash equivalents	(10,480)	10,878	3,862
Cash and cash equivalents at beginning of year	38,467	27,589	23,727
Cash and cash equivalents at end of year	$27,987	$38,467	$27,589
Supplemental disclosure of cash flow information:			
Cash paid during the year for:			
Interest expense	$1,598	$1,058	$908
Income taxes	$1,095	$2,375	$2,790
Non-cash investing activities:			
Real estate acquired through foreclosure or deed in lieu of foreclosure	$—	$—	$1,109
Loans resulting from sale of other real estate owned	$—	$—	$1,686

See accompanying notes to consolidated financial statements.

AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. THE BUSINESS OF THE COMPANY

American River Bankshares (the "Company") was incorporated under the laws of the State of California in 1995 under the name of American River Holdings and changed its name in 2004 to American River Bankshares. As a bank holding company, the Company is authorized to engage in the activities permitted under the Bank Holding Company Act of 1956, as amended, and regulations thereunder. As a community oriented regional bank holding company, the principal communities served are located in Sacramento, Placer, Yolo, El Dorado, Amador, and Sonoma counties.

The Company owns 100% of the issued and outstanding common shares of its banking subsidiary, American River Bank ("ARB" or the "Bank"). ARB was incorporated in 1983. ARB accepts checking and savings deposits, offers money market deposit accounts and certificates of deposit, makes secured and unsecured commercial, secured real estate, and other installment and term loans and offers other customary banking services. ARB operates four full-service banking offices in Sacramento County, one full-service banking office in Placer County, two full-service banking offices in Sonoma County, and three full-service banking offices in Amador County. The Company also owns one inactive subsidiary, American River Financial.

ARB does not offer trust services or international banking services and does not plan to do so in the near future. The deposits of ARB are insured by the Federal Deposit Insurance Corporation (the "FDIC") up to applicable legal limits.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General

The accounting and reporting policies of the Company and its subsidiaries conform to accounting principles generally accepted in the United States of America and prevailing practices within the financial services industry.

Reclassifications

Certain reclassifications have been made to prior years' balances to conform to classifications used in 2018. Reclassifications did not affect prior year net income or shareholders' equity.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All material intercompany transactions and accounts among the Company and its subsidiaries have been eliminated in consolidation.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Cash and Cash Equivalents

For the purpose of the statement of cash flows, cash and due from banks and Federal funds sold are considered to be cash equivalents. Generally, Federal funds are sold for one-day periods.

Interest-Bearing Deposits in Banks

Interest-bearing deposits in banks mature within one year and are carried at cost.

Investment Securities

Investments are classified into the following categories:

- Available-for-sale securities, reported at fair value, with unrealized gains and losses excluded from earnings and reported, net of taxes, as accumulated other comprehensive income (loss) within shareholders’ equity.
- Held-to-maturity securities, which management has the positive intent and ability to hold to maturity, reported at amortized cost.

Management determines the appropriate classification of its investments at the time of purchase and may only change the classification in certain limited circumstances. All transfers between categories are accounted for at fair value. There were no transfers during the years ended December 31, 2018 and 2017.

Gains or losses on the sale of investment securities are computed on the specific identification method. Interest earned on investment securities is reported in interest income, net of applicable adjustments for accretion of discounts and amortization of premiums.

An investment security is impaired when its carrying value is greater than its fair value. Investment securities that are impaired are evaluated on at least a quarterly basis and more frequently when economic or market conditions warrant such an evaluation to determine whether a decline in their value is other than temporary. Management utilizes criteria such as the magnitude and duration of the decline and the intent and ability of the Company to retain its investment in the securities for a period of time sufficient to allow for an anticipated recovery in fair value, in addition to the reasons underlying the decline, to determine whether the loss in value is other than temporary. The term "other than temporary" is not intended to indicate that the decline is permanent, but indicates that the prospects for a near-term recovery of value is not necessarily favorable, or that there is a lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. For debt securities, once a decline in value is determined to be other than temporary and management does not intend to sell the security or it is more likely than not that management will not be required to sell the security before recovery, only the portion of the impairment loss representing credit exposure is recognized as a charge to earnings, with the balance recognized as a charge to other comprehensive income. If management intends to sell the security or it is more likely than not that management will be required to sell the security before recovering its forecasted cost, the entire impairment loss is recognized as a charge to earnings. For equity securities, the entire amount of impairment is recognized through earnings.

Federal Home Loan Bank Stock

Investments in Federal Home Loan Bank of San Francisco (the "FHLB") stock are carried at cost and are redeemable at par with certain restrictions. Investments in FHLB stock are necessary to participate in FHLB programs.

AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

2.SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Loans and Leases

Loans and leases that management has both the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal amounts outstanding, adjusted for unearned income, deferred loan origination fees and costs, purchase premiums and discounts, write-downs and the allowance for loan and lease losses. Loan and lease origination fees, net of certain deferred origination costs, and purchase premiums and discounts are recognized as an adjustment to the yield of the related loans and leases.

For all classes of loans and leases, the accrual of interest is discontinued when, in the opinion of management, there is an indication that the borrower may be unable to meet payment requirements within an acceptable time frame relative to the terms stated in the loan agreement. Upon such discontinuance, all unpaid accrued interest is reversed against current income unless the loan or lease is well secured and in the process of collection. Interest received on nonaccrual loans and leases is either applied against principal or reported as interest income, according to management’s judgment as to the collectability of principal. Generally, loans and leases are restored to accrual status when the obligation is brought current and has performed in accordance with the contractual terms for a reasonable period of time and the ultimate collectability of the total contractual principal and interest is no longer in doubt.

Direct financing leases are carried net of unearned income. Income from leases is recognized by a method that approximates a level yield on the outstanding net investment in the lease.

Loan Sales and Servicing

Included in the loan and lease portfolio are Small Business Administration (“SBA”) loans and Farm Service Agency guaranteed loans that may be sold in the secondary market. At the time the loan is sold, the related right to service the loan is either retained, with the Company earning future servicing income, or released in exchange for a one-time servicing-released premium. Loans subsequently transferred to the loan portfolio are transferred at the lower of cost or fair value at the date of transfer. Any difference between the carrying amount of the loan and its outstanding principal balance is recognized as an adjustment to yield by the interest method. There were no loans held for sale at December 31, 2018 and 2017.

SBA and Farm Service Agency loans with unpaid balances of $109,000 and $138,000 were being serviced for others as of December 31, 2018 and 2017, respectively. The Company also serviced loans that are participated with other financial institutions totaling $7,815,000 and $7,941,000 as of December 31, 2018 and 2017, respectively.

Servicing rights acquired through 1) a purchase or 2) the origination of loans which are sold or securitized with servicing rights retained are recognized as separate assets or liabilities. Servicing assets or liabilities are initially recorded at fair value and are subsequently amortized in proportion to and over the period of the related net servicing income or expense. Servicing assets are periodically evaluated for impairment. Servicing assets were not considered material for disclosure purposes at December 31, 2018 and 2017.

Allowance for Loan and Lease Losses

The allowance for loan and lease losses is an estimate of probable credit losses inherent in the Company’s credit portfolio that have been incurred as of the balance-sheet date. The allowance is established through a provision for loan and lease losses which is charged to expense. Additions to the allowance are expected to maintain the adequacy of the total allowance after credit losses and loan growth. Credit exposures determined to be uncollectible are charged against the allowance. Cash received on previously charged off amounts is typically recorded as a recovery to the allowance. The overall allowance consists of two primary components, specific reserves related to impaired credits and general reserves for inherent probable losses related to credits that are not impaired.

AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Loan and Lease Losses (Continued)

For all classes of the portfolio, a loan or lease is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due, including principal and interest, according to the contractual terms of the original agreement. Factors considered by management in determining impairment include payment status, and the probability of collecting scheduled principle and interest payments when due. Impaired loans are individually evaluated to determine the extent of impairment, if any, except for smaller-balance loans that are collectively evaluated for credit risk. When a loan or lease is impaired, the Company measures impairment based on the present value of expected future cash flows discounted at the credit's original interest rate, the credit's observable market price, or the fair value of the collateral if the credit is collateral dependent. A loan or lease is collateral dependent if the repayment of the credit is expected to be provided solely by the sale or operation of the underlying collateral.

For all portfolio segments, a restructuring of a debt constitutes a troubled debt restructuring ("TDR") if the Company grants a concession to the borrower for economic or legal reasons related to the borrower's financial difficulties that it would not otherwise consider. Restructured workout loans typically present an elevated level of credit risk as the borrowers are not able to perform according to the original contractual terms. Loans or leases that are reported as TDRs are considered impaired and measured for impairment as described above.

For all portfolio segments, the determination of the general reserve for loans and leases that are not impaired is based on estimates made by management, to include, but not limited to, consideration of historical losses by portfolio segment, internal asset classifications, and qualitative factors to include economic trends in the Company's service areas, industry experience and trends, geographic concentrations, estimated collateral values, the Company's underwriting policies, the character of the credit portfolio, and probable losses inherent in the portfolio taken as a whole.

The Company determines a separate allowance for each portfolio segment. These portfolio segments include commercial, real estate construction (including land and development loans), residential real estate, multi-family real estate, commercial real estate, leases, agriculture, and consumer loans. The allowance for loan and lease losses attributable to each portfolio segment, which includes both impaired credits and credits that are not impaired, is combined to determine the Company's overall allowance, which is included as a component of loans and leases on the consolidated balance sheet and available for all loss exposures.

The Company assigns a risk rating to all loans and periodically performs detailed reviews of all such loans over a certain threshold to identify credit risks and to assess the overall collectability of the portfolio. These risk ratings are also subject to examination by independent specialists engaged by the Company and the Company's regulators. During the internal reviews, management monitors and analyzes the financial condition of borrowers and guarantors, trends in the industries in which borrowers operate and the fair values of collateral securing these loans. These credit quality indicators are used to assign a risk rating to each individual credit. The risk ratings can be grouped into six major categories, defined as follows:

Pass – A pass loan is a strong credit with no existing or known potential weaknesses deserving of management's close attention.

Watch – A watch credit is a loan or lease that otherwise meets the definition of a standard or minimum acceptable quality loan, but which requires more than normal attention due to any of the following items: deterioration of borrower financial condition less severe than those warranting more adverse grading, deterioration of repayment ability and/or collateral value, increased leverage, adverse effects from a downturn in the economy, local market or industry, adverse changes in local or regional employer, management changes (including illness, disability, and death), and adverse legal action. Payments are current per the terms of the agreement. If conditions persist or worsen, a more severe risk grade may be warranted.

AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Loan and Lease Losses (Continued)

Special Mention – A special mention credit is a loan or lease that has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the credit or in the Company's position at some future date. Special Mention credits are not adversely classified and do not expose the Company to sufficient risk to warrant adverse classification.

Substandard – A substandard credit is a loan or lease that is not adequately protected by the current sound worth and paying capacity of the borrower or the value of the collateral pledged, if any. Credits classified as substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. Well defined weaknesses include inadequate cash flow or collateral support, a project's lack of marketability, failure to complete construction on time or a project's failure to fulfill economic expectations. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

Doubtful – Credits classified as doubtful are loans or leases that have all the weaknesses inherent in those classified as substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions and values, highly questionable and improbable.

Loss – Credits classified as loss are loans or leases considered uncollectible and charged off immediately.

The general reserve component of the allowance for loan and lease losses also consists of reserve factors that are based on management's assessment of the following for each portfolio segment: (1) inherent credit risk, (2) historical losses and (3) other qualitative factors. These reserve factors are inherently subjective and are driven by the repayment risk associated with each portfolio segment described below.

Real Estate- Commercial – Commercial real estate mortgage loans generally possess a higher inherent risk of loss than other real estate portfolio segments, except land and construction loans. Adverse economic developments or an overbuilt market impact commercial real estate projects and may result in troubled loans. Trends in vacancy rates of commercial properties impact the credit quality of these loans. High vacancy rates reduce operating revenues and the ability for properties to produce sufficient cash flow to service debt obligations.

Real Estate- Construction – These loans generally possess a higher inherent risk of loss than other real estate portfolio segments. A major risk arises from the necessity to complete projects within specified cost and time lines. Trends in the construction industry significantly impact the credit quality of these loans, as demand drives construction activity. In addition, trends in real estate values significantly impact the credit quality of these loans, as property values determine the economic viability of construction projects.

Real Estate- Multi-family – Multi-family loans are non-construction term mortgages for the acquisition, refinance, or improvement of residential rental properties with generally more than 4 dwelling units. Underwriting is generally based on borrower creditworthiness, sufficiency of net operating income to service the bank loan payment, and a prudent loan-to-value ratio, among other factors.

AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Loan and Lease Losses (Continued)

Real Estate- Residential – Residential loans are generally loans to purchase or refinance 1-4 unit single-family residences, either owner-occupied or investor-owned. Some residential loans are short term to match their intended source of repayment through sale or refinance. The remainder are fixed or floating-rate term first mortgages with an original maturity between 2 and 10 years, generally with payments based on a 25-30 year amortization.

Commercial – Commercial loans generally possess a lower inherent risk of loss than real estate portfolio segments because these loans are generally underwritten to existing cash flows of operating businesses. Debt coverage is provided by business cash flows and economic trends influenced by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans.

Lease Financing Receivable – Leases originated by the bank are non-consumer finance leases (as contrasted with operating leases) for the acquisition of titled and non-titled business equipment. Leases are generally amortized over a period from 36 to 84 months, depending on the useful life of the equipment acquired. Residual (balloon) payments at lease end range from 0-20% of original cost, and are a non-optional obligation of the lessee. Lessees are contractually responsible for all costs, expenses, taxes, and liability associated with the leased equipment.

Agricultural – Loans secured by crop production and livestock are especially vulnerable to two risk factors that are largely outside the control of the Company and borrowers: commodity prices and weather conditions.

Consumer – The consumer loan portfolio is comprised of a large number of small loans scheduled to be amortized over a specific period. Most installment loans are made directly for consumer purchases, but business loans granted for the purchase of heavy equipment or industrial vehicles may also be included. Also included in the consumer loan portfolio are home equity lines of credit and loans purchased from a specialty lender that originates classic and collector auto loans. Economic trends determined by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans. Weak economic trends indicate that the borrowers’ capacity to repay their obligations may be deteriorating.

Although management believes the allowance to be adequate, ultimate losses may vary from its estimates. At least quarterly, the Board of Directors reviews the adequacy of the allowance, including consideration of the relative risks in the portfolio, current economic conditions and other factors. If the Board of Directors and management determine that changes are warranted based on those reviews, the allowance is adjusted. In addition, the Company’s primary regulators, the FDIC and the California Department of Business Oversight, as an integral part of their examination process, review the adequacy of the allowance. These regulatory agencies may require additions to the allowance based on their judgment about information available at the time of their examinations.

Allowance for Credit Losses on Off-Balance-Sheet Credit Exposures

The Company also maintains a separate allowance for off-balance-sheet commitments. Management estimates probable incurred losses using historical data and utilization assumptions. The allowance for off-balance-sheet commitments is included in accrued interest payable and other liabilities on the consolidated balance sheet.

AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Other Real Estate Owned (OREO)

Other real estate owned includes real estate acquired in full or partial settlement of loan obligations. When property is acquired, any excess of the recorded investment in the loan balance and accrued interest income over the estimated fair market value of the property less estimated selling costs is charged against the allowance for loan and lease losses. Any excess of the fair value over the loan balance less estimated selling costs is recorded as noninterest income-other income. A valuation allowance for losses on other real estate may be maintained to provide for temporary declines in value. The valuation allowance is established through a provision for losses on other real estate which is included in other expenses. Subsequent gains or losses on sales or write-downs resulting from permanent impairments are recorded in other income or expense as incurred.

Premises and Equipment

Premises and equipment are carried at cost less accumulated depreciation. Land is not depreciated. Depreciation is determined using the straight-line method over the estimated useful lives of the related assets. The useful life of the building and improvements is forty years. The useful lives of furniture, fixtures and equipment are estimated to be three to ten years. Leasehold improvements are amortized over the life of the asset or the term of the related lease, whichever is shorter. When assets are sold or otherwise disposed of, the cost and related accumulated depreciation or amortization are removed from the accounts, and any resulting gain or loss is recognized in income for the period. The cost of maintenance and repairs is charged to expense as incurred. Impairment of long-lived assets is evaluated by management based upon an event or changes in circumstances surrounding the underlying assets which indicate long-lived assets may be impaired.

Goodwill and Intangible Assets

Business combinations involving the Company's acquisition of equity interests or net assets of another enterprise or the assumption of net liabilities in an acquisition of branches constituting a business may give rise to goodwill.

Goodwill represents the excess of the cost of an acquired entity over the net of the amounts assigned to assets acquired and liabilities assumed. The value of goodwill is ultimately derived from the Company's ability to generate net earnings after the acquisition and is not deductible for tax purposes. A decline in net earnings could be indicative of a decline in the fair value of goodwill and result in impairment. For that reason, goodwill is assessed for impairment at least annually. Impairment exists when a reporting unit's carrying value of goodwill exceeds its fair value. At December 31, 2018, the Company had one reporting unit and that reporting unit had positive equity and the Company elected to perform a qualitative assessment to determine if it was more likely than not that the fair value of the reporting unit exceeded its carrying value, including goodwill. The qualitative assessment indicated that it was more likely than not that the fair value of the reporting unit exceeded its carrying value, resulting in no impairment.

Bank-Owned Life Insurance

The Company has purchased life insurance policies on certain key executives. Bank owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Income Taxes

The Company files its income taxes on a consolidated basis with its subsidiaries. The allocation of income tax expense represents each entity's proportionate share of the consolidated provision for income taxes.

The Company accounts for income taxes using the balance sheet method, under which deferred tax assets and liabilities are recognized for the tax consequences of temporary differences between the reported amounts of assets and liabilities and their tax bases. The deferred provision for income taxes is the result of the net change in the deferred tax asset and deferred tax liability balances during the year. This amount combined with the current taxes payable or refundable, results in the income tax expense for the current year. On the consolidated balance sheet, net deferred tax assets are included in accrued interest receivable and other assets.

Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment. On December 22, 2017, President Trump signed into law "H.R.1" commonly referred to as the Tax Cuts and Jobs Act (the "Tax Act"). During 2017, the Company recorded an income tax expense adjustment of $1,220,000 related to the Tax Act. The adjustment relates to revaluing the Company's net deferred tax assets using the new lower corporate federal income tax rate of 21% which became effective January 1, 2018, a reduction from the Company's 2017 rate of 34%.

The realization of deferred income tax assets is assessed and a valuation allowance is recorded if it is "more likely than not" that all or a portion of the deferred tax assets will not be realized. "More likely than not" is defined as greater than a 50% chance. All available evidence, both positive and negative is considered to determine whether, based on the weight of that evidence, a valuation allowance is needed. Based upon the Company's analysis of available evidence, the Company determined that it is "more likely than not" that all of the deferred income tax assets as of December 31, 2018 and 2017 will be fully realized and therefore no valuation allowance was recorded.

The Company uses a comprehensive model for recognizing, measuring, presenting and disclosing in the financial statements tax positions taken or expected to be taken on a tax return. A tax position is recognized as a benefit only if it is “more likely than not” that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the “more likely than not” test, no tax benefit is recorded. Interest expense and penalties associated with unrecognized tax benefits, if any, are classified as income tax expense in the consolidated statement of income.

Comprehensive Income

Comprehensive income is reported in addition to net income for all periods presented. Comprehensive income consists of net income and other comprehensive income (loss). Unrealized gains and losses on the Company’s available-for-sale investment securities are included in other comprehensive income (loss), adjusted for realized gains or losses included in net income, net of tax. Total comprehensive income and the components of accumulated other comprehensive income (loss) are presented in the consolidated statements of comprehensive income.

Earnings Per Share

Basic earnings per share (“EPS”), which excludes dilution, is computed by dividing income available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock, such as stock options or restricted stock, result in the issuance of common stock that share in the earnings of the Company. The treasury stock method has been applied to determine the dilutive effect of stock options and restricted stock in computing diluted EPS. Earnings and dividends per share are restated for all stock splits and stock dividends through the date of issuance of the consolidated financial statements.

AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

2.SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

There were no stock splits or stock dividends in 2018, 2017 or 2016.

Stock-Based Compensation

At December 31, 2018, the Company had two stock-based compensation plans, which are described more fully in Note 13. Compensation expense recorded in 2018, 2017, and 2016 totaled $227,000, $273,000 and $331,000, respectively. Compensation expense is recognized over the vesting period on a straight line accounting basis.

The fair value of each option award is estimated on the date of grant using a Black-Scholes-Merton based option valuation model that uses the assumptions noted in the following table. Because Black-Scholes-Merton based option valuation models incorporate ranges of assumptions for inputs, those ranges are disclosed. Expected volatilities are based on historical volatility of the Company’s stock and other factors. The Company uses historical data to estimate the dividend yield, option life and forfeiture rate within the valuation model. The expected option life represents the period of time that options granted are expected to be outstanding. The risk-free rate for the period representing the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

Operating Segments

While the chief decision-makers monitor the revenue streams of the various products and services, operations are managed and financial performance is evaluated on a Company-wide basis. Operating segments are aggregated into one as operating results for all segments are similar. Accordingly, all of the financial service operations are considered by management to be aggregated in one reportable operating segment.

Recently Issued Financial Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (the "FASB") and the International Accounting Standards Board (the "IASB") jointly issued a comprehensive new revenue recognition standard that supersedes nearly all existing revenue recognition guidance under GAAP and International Financial Reporting Standards ("IFRS"). Previous revenue recognition guidance in GAAP consisted of broad revenue recognition concepts together with numerous revenue requirements for particular industries or transactions, which sometimes resulted in different accounting for economically similar transactions. In contrast, IFRS provided limited revenue recognition guidance and, consequently, could be difficult to apply to complex transactions. Accordingly, the FASB and the IASB initiated a joint project to clarify the principles for recognizing revenue and to develop a common revenue standard for U.S. GAAP and IFRS that: (1) removes inconsistencies and weaknesses in revenue requirements; (2) provides a more robust framework for addressing revenue issues; (3) improves comparability of revenue recognition practices across entities, industries, jurisdictions, and capital markets; (4) provides more useful information to users of financial statements through improved disclosure requirements; and (5) simplifies the preparation of financial statements by reducing the number of requirements to which an entity must refer. To meet those objectives, the FASB issued Accounting Standards Update ("ASU") No. 2014-09, "*Revenue from Contracts with Customers.*" The standard's core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. In doing so, companies generally will be required to use more judgment and make more estimates than under current guidance. These may include identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. The standard was initially effective for public entities for interim and annual reporting periods beginning after December 15, 2016; early adoption was not permitted. However, in August 2015, the FASB issued ASU No. 2015-14, "*Revenue from Contracts with Customers - Deferral of the Effective Date*" which deferred the effective date by one year (i.e., interim and annual reporting periods beginning after December 15, 2017). For financial reporting purposes, the standard allows for either full retrospective adoption, meaning the standard is applied to all of the periods presented, or modified retrospective adoption, meaning the standard is applied only to the most current period presented in the financial statements with the cumulative effect of initially applying the standard recognized at the date of initial application. In addition, the FASB issued targeted updates to clarify specific implementation issues of ASU 2014- 09. These updates include ASU No. 2016-08, "*Principal versus Agent Considerations (Reporting Revenue Gross versus Net),*" ASU No. 2016-10, "*Identifying Performance Obligations and Licensing,*" ASU No. 2016-12, "*Narrow-Scope Improvements and Practical Expedients,*" and ASU No. 2016-20 "*Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers.*" The Company has assessed its revenue streams and reviewed its contracts that could potentially be affected by the ASU including deposit related fees, interchange fees, and merchant income, to determine the impact the new guidance has on the Company's financial position, results of operations or cash flows. The Company adopted ASU No. 2014-09 on January 1, 2018. The effects of adopting ASU No. 2014-09 did not change the amounts of revenue recorded for the Company's in-scope revenue streams.

AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

In January 2016, the FASB issued ASU No. 2016-01, "*Recognition and Measurement of Financial Assets and Financial Liabilities.*" This ASU addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments by making targeted improvements to GAAP as follows: (1) require equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. However, an entity may choose to measure equity investments that do not have readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer; (2) simplify the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment. When a qualitative assessment indicates that impairment exists, an entity is required to measure the investment at fair value; (3) eliminate the requirement to disclose the fair value of financial instruments measured at amortized cost for entities that are not public business entities; (4) eliminate the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; (5) require public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; (6) require an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments; (7) require separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements; and (8) clarify that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets. ASU No. 2016-01 is effective for interim and annual reporting periods beginning after December 15, 2017. Early application was permitted as of the beginning of the fiscal year of adoption only for provisions (3) and (6) above. Early adoption of the other provisions mentioned above were not permitted. The Company adopted ASU No. 2016-01 on January 1, 2018. The effects of adopting ASU No. 2016-01 resulted in the Company using the exit price notion for valuing financial instruments in 2018, but did not have a material impact on the Company's financial position, results of operations or cash flows.

In February 2016, the FASB issued ASU No. 2016-02, "*Leases.*" Under the new guidance, lessees will be required to recognize the following for all leases (with the exception of short-term leases): 1) a lease liability, which is the present value of a lessee's obligation to make lease payments, and 2) a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Lessor accounting under the new guidance remains largely unchanged as it is substantially equivalent to existing guidance for sales-type leases, direct financing leases, and operating leases. Leveraged leases have been eliminated, although lessors can continue to account for existing leveraged leases using the current accounting guidance. Other limited changes were made to align lessor accounting with the lessee accounting model and the new revenue recognition standard. All entities will classify leases to determine how to recognize lease-related revenue and expense. Quantitative and qualitative disclosures will be required by lessees and lessors to meet the objective of enabling users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases. The intention is to require enough information to supplement the amounts recorded in the financial statements so that users can understand more about the nature of an entity's leasing activities. ASU No. 2016-02 was effective for interim and annual reporting periods beginning after December 15, 2018; early adoption was permitted. All entities are required to use a modified retrospective approach for leases that exist or are entered into after the beginning of the earliest comparative period in the financial statements. They have the option to use certain relief; full retrospective application is prohibited. Based on evaluation of the Company's current lease obligations, the Company has determined that the provisions of ASU No. 2016-02 resulted in an increase in assets to recognize the present value of the lease obligations with a corresponding increase in liabilities. The Company currently leases nine of its office leases under operating leases. The Company adopted ASU No. 2016-02 on January 1, 2019. The Company's present value of future lease payments as of January 1, 2019 is $3,570,000, to be recorded as a right-of-use asset with an offsetting liability. The effects of adopting ASU No. 2016-02 did not have a material impact on the Company's financial position, results of operations or cash flows.

AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

In June 2016, the FASB issued ASU No. 2016-13, "*Measurement of Credit Losses on Financial Instruments.*" This ASU significantly changes how entities will measure credit losses for most financial assets and certain other instruments that aren't measured at fair value through net income. In issuing the standard, the FASB is responding to criticism that today's guidance delays recognition of credit losses. The standard will replace today's "incurred loss" approach with an "expected loss" model. The new model, referred to as the current expected credit loss ("CECL") model, will apply to: (1) financial assets subject to credit losses and measured at amortized cost, and (2) certain off-balance sheet credit exposures. This includes, but is not limited to, loans, leases, held-to-maturity securities, loan commitments, and financial guarantees. The CECL model does not apply to available-for-sale ("AFS") debt securities. For AFS debt securities with unrealized losses, entities will measure credit losses in a manner similar to what they do today, except that the losses will be recognized as allowances rather than reductions in the amortized cost of the securities. As a result, entities will recognize improvements to estimated credit losses immediately in earnings rather than as interest income over time, as they do today. The ASU also simplifies the accounting model for purchased credit-impaired debt securities and loans. ASU 2016-13 also expands the disclosure requirements regarding an entity's assumptions, models, and methods for estimating the allowance for loan and lease losses. In addition, entities will need to disclose the amortized cost balance for each class of financial asset by credit quality indicator, disaggregated by the year of origination. ASU No. 2016-13 is effective for interim and annual reporting periods beginning after December 15, 2019; early adoption is permitted for interim and annual reporting periods beginning after December 15, 2018. Entities will apply the standard's provisions as a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective (i.e., modified retrospective approach). While the Company is currently evaluating the provisions of ASU No. 2016-13 to determine the potential impact the new standard will have on the Company's Consolidated Financial Statements, it has taken steps to prepare for the implementation when it becomes effective, such as forming an internal task force, gathering pertinent data, consulting with outside professionals, evaluating its current IT systems, and purchasing a software solution. The Company intends to begin processing information with the new CECL specific software during the first part of 2019 and to disclose potential impact of this modeling once it becomes available.

Revenue From Contracts With Customers

As discussed above, on January 1, 2018 the Company adopted ASC Topic 606, as revised under ASU's 2014-09, 2014-08 and 2016-20, using the modified retrospective method as of January 1, 2018. Other income disclosures for periods beginning after January 1, 2018 are presented under revised ASC Topic 606, which have not materially changed from the prior year amounts. Consistent with Topic 606, noninterest income covered by this guidance is recognized as services are transferred to our customers in an amount that reflects the consideration we expect to be entitled to in exchange for those services.

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AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

2.SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Deposit Service Charges — Deposit service charges primarily consist of fees earned from our treasury management services. These services include bill pay, ACH, positive pay, lockbox, remote deposit capture, online banking and cash vault, among others. Customers are given the option to pay for these services in cash or by offsetting the fees for these services against an earnings credit that is given for maintaining noninterest-bearing deposits. The Company's performance obligations on its treasury services are satisfied either at the time of the transaction or over the course of a month. Most customers pay deposit charges on a monthly basis.

Merchant and Bankcard Fees — The Company earns various types of network transaction fees from third party payment network providers which consist of (i) interchange fees earned from the payment network as a debit card issuer and (ii) ongoing merchant fees earned by the Company for referring our clients to the payment processing provider which allows our clients to accept credit cards as a form of payment. The Company is an issuer of debit cards only as it relates to Merchant and Bankcard fees. Interchange income, which is settled on a daily basis, is recognized as settlement occurs. Chargebacks have not historically been, nor are they expected to be significant to the overall fee revenue and are recognized upon occurrence. Referral and merchant fees are recognized when the transaction occurs.

3.FAIR VALUE MEASUREMENTS

The following tables present information about the Company's assets and liabilities measured at fair value on a recurring and nonrecurring basis as of December 31, 2018 and December 31, 2017. They indicate the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value. In general, fair values determined by Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access. Fair values determined by Level 2 inputs utilize inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar assets and liabilities in active markets, and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals. Level 3 inputs are unobservable inputs for the asset or liability, and include situations where there is little, if any, market activity for the asset or liability. In 2018, the Company adopted the provisions of Accounting Standard Update 2016-01 "*Recognition and Measurement of Financial Assets and Financial Liabilities*" ("ASU 2016-01"). ASU 2016-01 requires the Company to use the exit price notion when measuring the fair value of financial instruments. The Company used the exit price notion for valuing financial instruments in 2018 and the entry price notion for valuing financial instruments in 2017. In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Company’s assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability.

Estimated fair values are disclosed for financial instruments for which it is practicable to estimate fair value. These estimates are made at a specific point in time based on relevant market data and information about the financial instruments. These 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 the realization of unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of these estimates.

The carrying amounts and estimated fair values of the Company’s financial instruments are as follows (dollars in thousands):

AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

3.FAIR VALUE MEASUREMENTS (Continued)

December 31, 2018	Carrying Amount	Fair Value Measurements Using: Level 1	Level 2	Level 3	Total
Financial assets:					
Cash and due from banks	$20,987	$20,987	$—	$—	$20,987
Federal funds sold	7,000	7,000	—	—	7,000
Interest-bearing deposits in banks	1,746	—	1,746	—	1,746
Available-for-sale securities	294,933	4,976	289,957	—	294,933
Held-to-maturity securities	292	—	306	—	306
FHLB stock	3,932	N/A	N/A	N/A	N/A
Loans and leases, net	318,516	—	—	315,235	315,235
Accrued interest receivable	1,959	—	1,044	915	1,959
Financial liabilities:					
Deposits:					
Noninterest-bearing	$214,745	$214,745	$—	$—	$214,745
Savings	72,522	72,522	—	—	72,522
Money market	145,831	145,831	—	—	145,831
NOW accounts	69,489	69,489	—	—	69,489
Time Deposits	88,087	—	88,078	—	88,078
Short-term borrowings	5,000	5,000	—	—	5,000
Long-term borrowings	10,500	—	10,733	—	10,733
Accrued interest payable	63	—	63	—	63

December 31, 2017	Carrying Amount	Fair Value Measurements Using: Level 1	Level 2	Level 3	Total
Financial assets:					
Cash and due from banks	$38,467	$38,467	$—	$—	$38,467
Interest-bearing deposits in banks	1,746	—	1,750	—	1,750
Available-for-sale securities	262,322	66	262,256	—	262,322
Held-to-maturity securities	378	—	404	—	404
FHLB stock	3,932	N/A	N/A	N/A	N/A
Loans and leases, net	308,713	—	—	317,900	317,900
Accrued interest receivable	1,956	—	1,124	832	1,956
Financial liabilities:					
Deposits:					

Noninterest-bearing	$215,528	$215,528	$—	$—	$215,528
Savings	66,130	66,130	—	—	66,130
Money market	130,032	130,032	—	—	130,032
NOW accounts	64,709	64,709	—	—	64,709
Time Deposits	79,681	—	79,614	—	79,614
Short-term borrowings	3,500	3,500	—	—	3,500
Long-term borrowings	12,000	—	11,978	—	11,978
Accrued interest payable	65	—	65	—	65

Because no market exists for a significant portion of the Company's financial instruments, fair value estimates are based on judgments regarding current economic conditions, risk characteristics of various financial instruments and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the fair values presented.

AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

3.FAIR VALUE MEASUREMENTS (Continued)

The following methods and assumptions were used by the Company to estimate the fair values of its financial instruments at December 31, 2017:

Cash and due from banks: The carrying amounts of cash and short-term instruments, including Federal funds sold, approximate fair values and are classified as Level 1.

Interest-bearing deposits in banks: The fair values of interest-bearing deposits in banks are estimated by discounting their future cash flows using rates at each reporting date for instruments with similar remaining maturities offered by comparable financial institutions and are classified as Level 2.

Investment securities: For investment securities, fair values are based on quoted market prices, where available, and are classified as Level 1. If quoted market prices are not available, fair values are estimated using quoted market prices for similar securities and indications of value provided by brokers and are classified as Level 2.

FHLB stock: FHLB stock is not publically traded, as such, it is not practicable to determine the fair value of FHLB stock due to restrictions placed on its transferability.

Loans and leases: Fair values of loans, excluding loans held for sale, are estimated as follows: For variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values resulting in a Level 3 classification. Fair values for other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality also resulting in a Level 3 classification. Impaired loans are valued at the lower of cost or fair value. The methods utilized to estimate the fair value of loans do not necessarily represent an exit price.

Deposits: The fair values disclosed for demand deposits (e.g. interest and non-interest checking, savings, and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e. their carrying amount) resulting in a Level 1 classification. For time deposits, the fair values for fixed rate certificates of deposit are estimated using a discounted cash flow methodology that applies market interest rates to a schedule of aggregated expected monthly maturities on time deposits resulting in a Level 2 classification.

Short-term and long-term borrowings: The fair value of short-term borrowings is estimated to be the carrying amount and is classified as Level 1. The fair value of long-term borrowings is estimated using a discounted cash flow analysis using interest rates currently available for similar debt instruments and are classified as Level 2.

Accrued interest receivable and payable: The carrying amount of accrued interest receivable and accrued interest payable approximates fair value resulting in a Level 2 or 3 classification consistent with the asset or liability with which it is associated.

Off-balance sheet instruments: Fair values for off-balance sheet, credit-related financial instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. The fair value of commitments was not material at December 31, 2017. They are excluded from the following tables.

AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

3.FAIR VALUE MEASUREMENTS (Continued)

Assets and liabilities measured at fair value on a recurring and non-recurring basis are presented in the following table:

(Dollars in thousands) December 31, 2018	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Gains (Losses)
Assets and liabilities measured on a recurring basis:					
Available-for-sale securities:					
U.S. Government Agencies and Sponsored Agencies	$ 269,049	$ —	$ 269,049	$ —	$ —
Corporate Debt Securities	6,508	—	6,508	—	—
Obligations of states and political subdivisions	14,400	—	14,400	—	—
U.S. Treasury bonds	4,976	4,976	—	—	—
Total recurring	$ 294,933	$ 4,976	$ 289,957	$ —	$ —

December 31, 2018	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Gains (Losses)
Assets and liabilities measured on a nonrecurring basis:					
Impaired loans:					

Real estate:					
Commercial	$ 5,274	$ —	$ —	$ 5,274	$ —
Other real estate owned:					
Land	957	—	—	957	(4)
Total nonrecurring	$ 6,231	$ —	$ —	$ 6,231	$ (4)

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AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

3.FAIR VALUE MEASUREMENTS (Continued)

(Dollars in thousands) December 31, 2017	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Gains (Losses)
Assets and liabilities measured on a recurring basis:					
Available-for-sale securities:					
U.S. Government Agencies and Sponsored Agencies	$ 232,869	$ —	$ 232,869	$ —	$ —
Corporate Debt Securities	6,626	—	6,626	—	—
Obligations of states and political subdivisions	22,715	—	22,715	—	—
Corporate stock	112	66	46	—	—
Total recurring	$ 262,322	$ 66	$ 262,256	$ —	$ —

December 31, 2017	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Gains (Losses)
Assets and liabilities measured on a nonrecurring basis:					
Impaired loans:					
Commercial	$ 1,598	$ —	$—	$ 1,598	$ (1,073)
Real estate:					
Commercial	178	—	—	178	—
Residential	329	—	—	329	—

Other real estate owned:					
Land	961	—	—	961	—
Total nonrecurring	$ 3,066	$ —	$ —	$ 3,066	$ (1,073)

U.S. Government Agencies and Sponsored Agencies consist predominately of residential mortgage-backed securities. There were no transfers between Levels 1 and 2 during the years ended December 31, 2018 or December 31, 2017.

The following methods were used to estimate the fair value of each class of financial instrument above:

Available-for-sale securities – Fair values for investment securities are based on quoted market prices, if available, and are considered Level 1, or evaluated using pricing models that vary by asset class and incorporate available trade, bid and other market information and are considered Level 2. Pricing applications apply available information, as applicable, through processes such as benchmark curves, benchmarking to like securities, sector groupings and matrix pricing.

AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

3. FAIR VALUE MEASUREMENTS (Continued)

Impaired loans – The fair value of collateral dependent impaired loans adjusted for specific allocations of the allowance for loan losses is generally based on recent real estate appraisals and/or evaluations. These appraisals and/or evaluations may utilize a single valuation approach or a combination of approaches including comparable sales, cost and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income and other available data. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. The valuation technique used for all Level 3 nonrecurring impaired loans is the sales comparison approach less a reserve for past dues taxes and selling costs ranging from 8% to 10%.

Other real estate owned – Certain commercial and residential real estate properties classified as OREO are measured at fair value, less costs to sell. Fair values are based on recent real estate appraisals and/or evaluations. These appraisals and/or evaluations may use a single valuation approach or a combination of approaches including comparable sales, cost and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income and other available data. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. The valuation technique used for all Level 3 nonrecurring OREO is the sales comparison approach less selling costs ranging from 8% to 10%.

4. GOODWILL AND OTHER INTANGIBLE ASSETS

At December 31, 2018 and 2017, goodwill totaled $16,321,000. Goodwill is evaluated annually for impairment under the provisions of the codification Topic 350, *Goodwill and Other Intangibles.* The most recent annual assessment was performed as of December 31, 2018, and at that time, the Company's reporting unit had positive equity and the Company elected to perform a qualitative assessment to determine if it was more likely than not that the fair value of the reporting unit exceeded its carrying value, including goodwill. The qualitative assessment indicated that it was more likely than not that the fair value of the reporting unit exceeded its carrying value, resulting in no impairment. Management determined that no impairment recognition was required for the years ended December 31, 2018, 2017 and 2016.

At December 31, 2018 and 2017, the Company did not have other intangible assets.

AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

5. INVESTMENT SECURITIES

The amortized cost and estimated fair value of investment securities at December 31, 2018 and 2017 consisted of the following (dollars in thousands):

Available-for-Sale

	2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Government Agencies and Sponsored Agencies	$271,685	$ 984	$ (3,620)	$269,049
Obligations of states and political subdivisions	14,440	165	(205)	14,400
Corporate Debt Securities	6,493	74	(59)	6,508
U.S. Treasury securities	4,979	—	(3)	4,976
	$297,597	$ 1,223	$ (3,887)	$294,933

	2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Government Agencies and Sponsored Agencies	$233,956	$ 1,184	$ (2,271)	$232,869
Obligations of states and political subdivisions	22,281	528	(94)	22,715
Corporate Debt Securities	6,490	160	(24)	6,626
Equity securities:				
Corporate stock	51	61	—	112
	$262,778	$ 1,933	$ (2,389)	$262,322

U.S. Government Agencies and U.S. Government-sponsored Agencies consist predominately of residential mortgage-backed securities. Net unrealized losses on available-for-sale investment securities totaling $2,664,000 were recorded, net of $788,000 in tax liabilities, as accumulated other comprehensive income within shareholders' equity at December 31, 2018. Proceeds and gross realized gains from the sale and call of available-for-sale investment securities for the year ended December 31, 2018 totaled $27,003,000 and $31,000, respectively. There were no transfers of available-for-sale investment securities during the year ended December 31, 2018.

Net unrealized gains on available-for-sale investment securities totaling $456,000 were recorded, net of $135,000 in tax liabilities, as accumulated other comprehensive income within shareholders' equity at December 31, 2017. Proceeds and gross realized gains from the sale, impairment and call of available-for-sale investment securities for the year ended December 31, 2017 totaled $31,434,000 and $161,000, respectively. There were no transfers of available-for-sale investment securities during the year ended December 31, 2017.

AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

5. INVESTMENT SECURITIES (Continued)

Proceeds and gross realized gains from the sale, impairment and call of available-for-sale investment securities for the year ended December 31, 2016 totaled $14,205,000 and $314,000, respectively.

Held-to-Maturity

	2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Government Agencies and Sponsored Agencies	$292	$ 14	$ —	$ 306

	2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Government Agencies and Sponsored Agencies	$378	$ 26	$ —	$ 404

There were no sales or transfers of held-to-maturity investment securities for the years ended December 31, 2018, 2017 and 2016.

The amortized cost and estimated fair value of investment securities at December 31, 2018 by contractual maturity are shown below (dollars in thousands).

	Available-for-Sale		Held-to-Maturity	
		Estimated		Estimated

	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Within one year	$5,234	$5,231		
After one year through five years	3,595	3,575		
After five years through ten years	13,923	13,905		
After ten years	3,160	3,173		
	25,912	25,884		
Investment securities not due at a single maturity date:				
U.S. Government Agencies and Sponsored Agencies	271,685	269,049	$ 292	$ 306
	$297,597	$294,933	$ 292	$ 306

Expected maturities will differ from contractual maturities because the issuers of the securities may have the right to call or prepay obligations with or without call or prepayment penalties.

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AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

5. INVESTMENT SECURITIES (Continued)

Investment securities with amortized costs totaling $88,460,000 and $55,834,000 and estimated fair values totaling $87,351,000 and $56,021,000 were pledged to secure State Treasury funds on deposit, public agency and bankruptcy trustee deposits and borrowing arrangements (see Note 10) at December 31, 2018 and 2017, respectively.

Investment securities with unrealized losses at December 31, 2018 and 2017 are summarized and classified according to the duration of the loss period as follows (dollars in thousands):

	2018					
	Less than 12 Months		12 Months or More		Total	
Available-for-Sale	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Debt securities:						
U.S. Government Agencies and Sponsored Agencies	$39,267	$ (310)	$138,894	$ (3,310)	$178,161	$ (3,620)
Obligations of states and political subdivisions	2,168	(28)	5,583	(177)	7,751	(205)
U.S. Treasury securities	4,976	(3)	—	—	4,976	(3)
Corporate bonds	497	(4)	1,938	(55)	2,435	(59)
	$46,908	$ (345)	$146,415	$ (3,542)	$193,323	$ (3,887)

	2017					
	Less than 12 Months		12 Months or More		Total	
Available-for-Sale	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Debt securities:						
U.S. Government Agencies and Sponsored Agencies	$119,455	$ (1,148)	$49,258	$ (1,123)	$168,713	$ (2,271)
	1,130	(9)	4,654	(85)	5,784	(94)

Obligations of states and political subdivisions						
Corporate bonds	1,967	(24)	—	—	1,967	(24)
	$122,552	$ (1,181)	$53,912	$ (1,208)	$176,464	$ (2,389)

At December 31, 2018, the Company held 220 securities of which 26 were in a loss position for less than twelve months and 97 were in a loss position for twelve months or more. These 97 securities consisted of mortgage-backed, corporate and municipal securities.

The unrealized loss on the Company's investments in securities is primarily driven by interest rates. Because the decline in market value is attributable to a change in interest rates and not credit quality, and because the Company has the ability and intent to hold these investments until recovery of fair value, which may be maturity, management does not consider these investments to be other-than-temporarily impaired.

AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

6. LOANS AND LEASES

Outstanding loans and leases are summarized as follows (dollars in thousands):

	December 31, 2018	December 31, 2017
Real estate – commercial	$199,894	$185,452
Real estate – construction	5,685	5,863
Real estate – multi-family	56,139	78,025
Real estate – residential	16,338	15,813
Commercial	29,650	25,377
Lease financing receivable	32	205
Agriculture	4,419	1,713
Consumer	10,714	945
	322,871	313,393
Deferred loan and lease origination fees and costs, net	37	(202)
Allowance for loan and lease losses	(4,392)	(4,478)
	$318,516	$308,713

Certain loans are pledged as collateral for available borrowings with the FHLB and the Federal Reserve Bank of San Francisco (the “FRB”). Pledged loans totaled $194,431,000 and $209,889,000 at December 31, 2018 and 2017, respectively (see Note 10).

The components of the Company’s lease financing receivable are summarized as follows (dollars in thousands):

	December 31, 2018	December 31, 2017

Future lease payments receivable	$ 33	$ 211
Residual interests	—	—
Unearned income	(1)	(6)
Net lease financing receivable	$ 32	$ 205

Future lease payments receivable are as follows (dollars in thousands):

Year Ending December 31,	
2019	$33
Total lease payments receivable	$33

Salaries and employee benefits totaling $357,000, $177,000 and $289,000 have been deferred as loan and lease origination costs for the years ended December 31, 2018, 2017 and 2016, respectively.

AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

7. ALLOWANCE FOR LOAN AND LEASE LOSSES

The following tables show the activity in the allowance for loan and lease losses for the years ended December 31, 2018, 2017 and 2016 and the allocation of the allowance for loan and lease losses as of December 31, 2018, 2017 and 2016 by portfolio segment and by impairment methodology (dollars in thousands):

	December 31, 2018									
		Real Estate				Other				
	Commercial	Commercial	Multi-Family	Construction	Residential	Leases	Agriculture	Consumer	Unallocated	Total
Allowance for Loan and Lease Losses										
Beginning balance	$447	$2,174	$1,047	$269	$205	$—	$31	$14	$291	$4,478
Provision for loan losses	422	(68)	(483)	(2)	15	(1)	57	247	(12)	175
Loans charged-off	(213)	—	—	—	—	—	—	(69)	—	(282)
Recoveries	12	8	—	—	—	1	—	—	—	21
Ending balance allocated to portfolio segments	$668	$2,114	$564	$267	$220	$—	$88	$192	$279	$4,392
Ending balance: Individually evaluated for impairment	$—	$132	$—	$—	$53	$—	$—	$—	$—	$185

Ending balance: Collectively evaluated for impairment	$668	$1,982	$564	$267	$167	$—	$88	$192	$279	$4,207
<u>Loans</u>										
Ending balance	$29,650	$199,894	$56,139	$5,685	$16,338	$32	$4,419	$10,714	$—	$322,871
Ending balance: Individually evaluated for impairment	$—	$7,783	$—	$—	$919	$—	$—	$—	$—	$8,702
Ending balance:										
Collectively evaluated for impairment	$29,650	$192,111	$56,139	$5,685	$15,419	$32	$4,419	$10,714	$—	$314,169

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AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

7. ALLOWANCE FOR LOAN AND LEASE LOSSES (Continued)

	December 31, 2017									
		Real Estate				Other				
	Commercial	Commercial	Multi-Family	Construction	Residential	Leases	Agriculture	Consumer	Unallocated	Total
Allowance for Loan and Lease Losses										
Beginning balance	$855	$2,050	$851	$446	$253	$1	$64	$24	$278	$4,822
Provision for loan losses	659	(104)	196	(177)	(48)	(42)	(33)	(14)	13	450
Loans charged-off	(1,073)	—	—	—	—	—	—	—	—	(1,073)
Recoveries	6	228	—	—	—	41	—	4	—	279
Ending balance allocated to portfolio segments	$447	$2,174	$1,047	$269	$205	$—	$31	$14	$291	$4,478
Ending balance: Individually evaluated for impairment	$—	$261	$21	$—	$73	$—	$—	$—	$—	$355
Ending balance: Collectively evaluated for impairment	$447	$1,913	$1,026	$269	$132	$—	$31	$14	$291	$4,123
Loans										
Ending balance	$25,377	$185,452	$78,025	$5,863	$15,813	$205	$1,713	$945	$—	$313,393

Ending balance: Individually evaluated for impairment	$1,598	$10,070	$474	$ —	$1,615	$—	$ —	$ —	$ —	$13,757
Ending balance: Collectively evaluated for impairment	$23,779	$175,382	$77,551	$ 5,863	$14,198	$205	$ 1,713	$ 945	$ —	$299,636

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AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

7. ALLOWANCE FOR LOAN AND LEASE LOSSES (Continued)

December 31, 2016										
		Real Estate				Other				
	Commercial	Commercial	Multi-Family	Construction	Residential	Leases	Agriculture	Consumer	Unallocated	Total
Allowance for Loan and Lease Losses										
Beginning balance	$860	$2,369	$228	$813	$319	$1	$77	$78	$230	$4,975
Provision for loan losses	(665)	(653)	623	(474)	(66)	—	(13)	(144)	48	(1,344)
Loans charged-off	—	(93)	—	—	—	—	—	(34)	—	(127)
Recoveries	660	427	—	107	—	—	—	124	—	1,318
Ending balance allocated to portfolio segments	$855	$2,050	$851	$446	$253	$1	$64	$24	$278	$4,822
Ending balance: Individually evaluated for impairment	$11	$246	$2	$—	$133	$—	$29	$—	$—	$421
Ending balance: Collectively evaluated for impairment	$844	$1,804	$849	$446	$120	$1	$35	$24	$278	$4,401

Loans

Ending balance	$35,374	$191,129	$73,373	$9,180	$15,718	$404	$2,302	$1,650	$—	$329,130
Ending balance: Individually evaluated for impairment	$157	$14,154	$482	$—	$2,147	$—	$357	$—	$—	$17,297
Ending balance: Collectively evaluated for impairment	$35,217	$176,975	$72,891	$9,180	$13,571	$404	$1,945	$1,650	$—	$311,833

AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

7. ALLOWANCE FOR LOAN AND LEASE LOSSES (Continued)

The following tables show the loan portfolio allocated by management's internal risk ratings as of December 31, 2018 and 2017 (dollars in thousands):

	December 31, 2018								
	Credit Risk Profile by Internally Assigned Grade								
		Real Estate				Other Credit Exposure			
	Commercial	Commercial	Multi-Family	Construction	Residential	Leases	Agriculture	Consumer	Total
Grade:									
Pass	$29,570	$185,548	$ 52,301	$ 5,685	$ 15,373	$32	$ 4,419	$ 10,691	$303,619
Watch	53	13,118	3,838	—	965	—	—	22	17,996
Special mention	—	1,087	—	—	—	—	—	1	1,088
Substandard	27	141	—	—	—	—	—	—	168
Doubtful	—	—	—	—	—	—	—	—	—
Total	$29,650	$199,894	$ 56,139	$ 5,685	$ 16,338	$32	$ 4,419	$ 10,714	$322,871

	December 31, 2017								
	Credit Risk Profile by Internally Assigned Grade								
		Real Estate				Other Credit Exposure			
	Commercial	Commercial	Multi-Family	Construction	Residential	Leases	Agriculture	Consumer	Total
Grade:									
Pass	$23,617	$164,815	$ 73,644	$ 5,863	$ 13,767	$205	$ 1,713	$ 713	$284,337
Watch	96	18,083	4,381	—	1,507	—	—	155	24,222
Special mention	66	2,265	—	—	539	—	—	70	2,940
Substandard	—	289	—	—	—	—	—	7	296
Doubtful	1,598	—	—	—	—	—	—	—	1,598
Total	$25,377	$185,452	$ 78,025	$ 5,863	$ 15,813	$205	$ 1,713	$ 945	$313,393

AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

7. ALLOWANCE FOR LOAN AND LEASE LOSSES (Continued)

The following tables show an aging analysis of the loan portfolio at December 31, 2018 and 2017 (dollars in thousands):

	December 31, 2018							
	30-59 Days Past Due	60-89 Days Past Due	Past Due Greater Than 90 Days	Total Past Due	Current	Total Loans	Past Due Greater Than 90 Days and Accruing	Nonaccrual
Commercial:								
Commercial	$—	$ —	$ —	$ —	$29,650	$ 29,650	$ —	$ 27
Real estate:								
Commercial	—	—	—	—	199,894	199,894	—	—
Multi-family	—	—	—	—	56,139	56,139	—	—
Construction	—	—	—	—	5,685	5,685	—	—
Residential	—	—	—	—	16,338	16,338	—	—
Other:								
Leases	—	—	—	—	32	32	—	—
Agriculture	—	—	—	—	4,419	4,419	—	—
Consumer	—	—	—	—	10,714	10,714	—	—
Total	$—	$ —	$ —	$ —	$322,871	$ 322,871	$ —	$ 27

AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

7. ALLOWANCE FOR LOAN AND LEASE LOSSES (Continued)

	December 31, 2017							
	30-59 Days Past Due	60-89 Days Past Due	Past Due Greater Than 90 Days	Total Past Due	Current	Total Loans	Past Due Greater Than 90 Days and Accruing	Nonaccrual
Commercial:								
Commercial	$—	$ —	$ —	$ —	$25,377	$ 25,377	$ —	$ 1,597
Real estate:								
Commercial	—	—	289	289	185,163	185,452	—	289
Multi-family	—	—	—	—	78,025	78,025	—	—
Construction	—	—	—	—	5,863	5,863	—	—
Residential	146	—	—	146	15,667	15,813	—	—
Other:								
Leases	—	—	—	—	205	205	—	—
Agriculture	—	—	—	—	1,713	1,713	—	—
Consumer	1	—	—	1	944	945	—	6
Total	$147	$ —	$ 289	$ 436	$312,957	$ 313,393	$ —	$ 1,892

AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

7. ALLOWANCE FOR LOAN AND LEASE LOSSES (Continued)

The following tables show information related to impaired loans as of and for the years ended December 31, 2018, 2017 and 2016 (dollars in thousands):

	December 31, 2018				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial	$—	$ —	$ —	$ —	$ 4
Real estate:					
Commercial	5,645	5,879	—	5,711	283
Multi-family	—	—	—	—	—
Residential	323	410	—	326	18
Other:					
Consumer	—	—	—	—	—
	$5,968	$ 6,289	$ —	$ 6,037	$ 305
With an allowance recorded:					
Commercial	$—	$ —	$ —	$ —	$ —
Real estate:					
Commercial	2,138	2,217	132	2,199	133
Multi-family	—	—	—	—	—
Residential	596	596	53	611	29
Other:					
Agriculture	—	—	—	—	—
Consumer	—	—	—	—	—
	$2,734	$ 2,813	$ 185	$ 2,810	$ 162
Total:					
Commercial	$—	$ —	$ —	$ —	$ 4
Real estate:					
Commercial	7,783	8,096	132	7,910	416

Multi-family	—	—	—	—	—
Residential	919	1,006	53	937	47
Other:					
Agriculture	—	—	—	—	—
Consumer	—	—	—	—	—
	$8,702	$ 9,102	$ 185	$ 8,847	$ 467

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AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

7. ALLOWANCE FOR LOAN AND LEASE LOSSES (Continued)

December 31, 2017				
Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income