UNITED SECURITY BANCSHARES
Form 10-Q
August 14, 2012

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

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

Commission file number: 000-32987

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

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

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

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

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

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

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

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

Aggregate market value of the Common Stock held by non-affiliates as of the last business day of the registrant's most

recently completed second fiscal quarter - June 30, 2012: $32,991,096

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

Common Stock, no par value
(Title of Class)

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

TABLE OF CONTENTS

Facing Page

Table of Contents

PART I. Financial Information

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

PART II. Other Information

Item 1.	Legal Proceedings	58
Item 1A.	Risk Factors	58
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	58
Item 3.	Defaults Upon Senior Securities	58
Item 4.	Mine Safety Disclosures	58
Item 5.	Other Information	58
Item 6.	Exhibits	58
Signatures		59

Table of Contents

PART I. Financial Information

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

(in thousands except shares)	June 30, 2012	December 31, 2011
Assets		
Cash and due from banks	$22,400	$ 28,052
Cash and due from FRB	76,990	96,132
Cash and cash equivalents	99,390	124,184
Interest-bearing deposits in other banks	2,103	2,187
Investment securities available for sale (at fair value)	35,553	38,458
Loans and leases	395,081	408,715
Unearned fees	(518)	(569)
Allowance for credit losses	(11,610)	(13,648)
Net loans	382,953	394,498
Accrued interest receivable	1,755	1,946
Premises and equipment – net	12,566	12,675
Other real estate owned	23,894	27,091
Intangible assets	383	553
Goodwill	4,488	4,488
Cash surrender value of life insurance	16,413	16,150
Investment in limited partnerships	3,677	4,149
Deferred income taxes - net	11,153	11,485
Other assets	11,279	13,468
Total assets	$605,607	$ 651,332
Liabilities & Shareholders' Equity		
Liabilities		
Deposits		
Noninterest bearing	$197,052	$ 224,907
Interest bearing	327,950	349,520
Total deposits	525,002	574,427
Accrued interest payable	95	111
Accounts payable and other liabilities	5,417	5,594
Junior subordinated debentures (at fair value)	9,276	9,027
Total liabilities	539,790	589,159
Shareholders' Equity		
Common stock, no par value 20,000,000 shares authorized, 13,803,806 and 13,531,832issued and outstanding, in 2012 and 2011, respectively	42,087	41,435
Retained earnings	24,029	21,447
Accumulated other comprehensive loss	(299)	(709)
Total shareholders' equity	65,817	62,173
Total liabilities and shareholders' equity	$605,607	$ 651,332

See notes to consolidated financial statements

Table of Contents

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

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

Other	646	594	1,272	1,107
Total noninterest expense	4,977	8,240	10,466	14,297
Income (Loss) Before Provision for Taxes	3,650	(9,948)	5,136	(9,542)
Provision (Benefit)for Taxes on Income	1,478	(3,599)	1,912	(3,549)
Net Income (Loss)	$2,172	$ (6,349)	$3,224	$ (5,993)
Other comprehensive income (loss), net of tax:				
Unrealized gain (loss) on available for sale securities, and past service costs of employee benefit plans – net of income tax expense (benefit) of $237, $(282), $273 and $(305).	355	(423)	410	(458)
Comprehensive Income (Loss)	$2,527	$ (6,772)	$3,634	$ (6,451)
Net Income (Loss) per common share				
Basic	$0.16	$ (0.46)	$0.23	$ (0.43)
Diluted	$0.16	$ (0.46)	$0.23	$ (0.43)
Shares on which net income per common shares were based				
Basic	13,803,806	13,803,806	13,803,806	13,803,806
Diluted	13,803,806	13,803,806	13,803,806	13,803,806

See notes to consolidated financial statements

Table of Contents

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

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

See notes to consolidated financial statements

Table of Contents

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

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

Net cash used in financing activities	(49,425)	(16,907)
Net (decrease) in cash and cash equivalents	(24,794)	(2,056)
Cash and cash equivalents at beginning of period	124,184	98,430
Cash and cash equivalents at end of period	$ 99,390	$ 96,374

See notes to consolidated financial statements

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

1.Organization and Summary of Significant Accounting and Reporting Policies

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

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

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

New Accounting Standards:

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

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

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

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

Table of Contents

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

2.Investment Securities Available for Sale and Other Investments

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

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

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

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

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

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

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

Table of Contents

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

The following summarizes temporarily impaired investment securities:

	Less than 12 Months		12 Months or More		Total	
(In thousands) June 30, 2012: Securities available for sale:	Fair Value (Carrying Amount)	Unrealized Losses	Fair Value (Carrying Amount)	Unrealized Losses	Fair Value (Carrying Amount)	Unrealized Losses
U.S. Government agencies	$ 2,128	$ (11)	$ 0	$ 0	$ 2,128	$ (11)
U.S. Government agency collateral mortgage obligations	0	0	0	0	0	0
Residential mortgage obligations	0	0	8,312	(1,283)	8,312	(1,283)
Total impaired securities	$ 2,128	$ (11)	$ 8,312	$ (1,283)	$ 10,440	$ (1,294)
December 31, 2011:						
Securities available for sale:						
U.S. Government agencies	$ 2,143	$ (7)	$ 0	$ 0	$ 2,143	$ (7)
U.S. Government agency collateral mortgage obligations	0	0	0	0	0	0
Residential mortgage obligations	0	0	7,994	(2,265)	7,994	(2,265)
Total impaired securities	$ 2,143	$ (7)	$ 7,994	$ (2,265)	$ 10,137	$ (2,272)

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

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

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

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

Table of Contents

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

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

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

June 30, 2012 (in 000’s)	RALI 2006-QS1G A10 Rated D	RALI 2006 QS8 A1 Rated D	CWALT 2007-8CB A9 Rated CCC	Total
Amortized cost – before OTTI	$ 3,719	$ 1,138	$ 7,015	$ 11,872
Credit loss	(713)	(239)	(1,325)	(2,277)
Other impairment (OCI)	(403)	(122)	(758)	(1,283)
Carrying amount – June 30, 2012	$ 2,603	$ 777	$ 4,932	$ 8,312
Total impairment - June 30, 2012	$ (1,116)	$ (361)	$ (2,083)	$ (3,560)

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

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

(in thousands)	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011
Beginning balance - credit losses	2,257	1,795	$ 2,208	$ 1,631
Additions:				
Initial credit impairments	0	0	0	0
Subsequent credit impairments	172	0	149	0
Reductions:				
For securities sold or credit losses realized on principal payments	(150)	(288)	(80)	(124)
Due to change in intent or requirement to sell		0	0	0
For increase expected in cash flows		0	0	0
Ending balance - credit losses	$ 2,279	$ 1,507	$ 2,277	$ 1,507

Table of Contents

3.Loans and Leases

Loans are comprised of the following:

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

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

Commercial and industrial loans represent 36.4% of total loans at June 30, 2012 and are generally made to support the ongoing operations of small-to-medium sized commercial businesses. Commercial and industrial loans have a high degree of industry diversification and provide working capital, financing for the purchase of manufacturing plants and equipment, or funding for growth and general expansion of businesses. A substantial portion of commercial and industrial loans are secured by accounts receivable, inventory, leases, or other collateral including real estate. The remainder are unsecured; however, extensions of credit are predicated upon the financial capacity of the borrower. Repayment of commercial loans generally comes from the cash flow of the borrower.

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

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

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

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

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

Table of Contents

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

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

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

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

Commitments to extend credit are agreements to lend to a customer, as long as there is no violation of any condition established in the contract. Substantially all of these commitments are at floating interest rates based on the Prime rate. Commitments generally have fixed expiration dates. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary, is based on management's credit evaluation. Collateral held varies but includes accounts receivable, inventory, leases, property, plant and equipment, residential real estate and income-producing properties.

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

Past Due Loans

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

June 30, 2012 (000's)	Loans 30-60 Days Past Due	Loans 61-89 Days Past Due	Loans 90 or More Days Past Due	Total Past Due Loans	Current Loans	Total Loans	Accruing Loans 90 or More Days Past Due
Commercial and Business Loans	$ 1,278	$ 179	$ 531	$ 1,988	$ 139,169	$ 141,157	$ 209
Government Program Loans	638	0	0	638	1,862	2,500	0
Total Commercial and Industrial	1,916	179	531	2,626	141,031	143,657	209
Commercial Real Estate Mortgage	3,243	0	0	3,243	129,269	132,512	0

Loans							
Residential Mortgage Loans	460	325	0	785	24,631	25,416	0
Home Improvement and Home Equity Loans	89	57	99	245	1,536	1,781	0
Total Real Estate Mortgage	3,792	382	99	4,273	155,436	159,709	0
Total RE Construction and Development Loans	325	0	2,099	2,424	48,209	50,633	0
Total Agricultural Loans	546	0	0	546	28,411	28,957	0
Consumer Loans	539	0	0	539	11,342	11,881	0
Overdraft protection Lines	0	0	0	0	0	0	0
Overdrafts	0	0	0	0	214	214	0
Total Installment/other	539	0	0	539	11,342	12,095	0
Commercial Lease Financing	0	0	0	0	30	30	0
Total Loans	$7,118	$561	$2,729	$10,408	$384,673	$395,081	$209

Table of Contents

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

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

Nonaccrual Loans

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

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

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

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

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

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

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

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

Table of Contents

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

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

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

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

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

	June 30, 2012	December 31, 2011
Commercial and Business Loans	$ 8,385	$ 4,722
Government Program Loans	107	358
Total Commercial and Industrial	8,492	5,080
Commercial Real Estate Loans	3,771	3,946
Residential Mortgages	37	43
Home Improvement and Home Equity Loans	111	0
Total Real Estate Mortgage	3,919	3,989
Total RE Construction and Development Loans	4,679	9,014
Total Agricultural Loans	661	0
Consumer Loans	438	15
Overdraft protection Lines	0	0
Overdrafts	0	0
Total Installment	438	15
Lease Financing	0	0
Total Loans	$ 18,189	$ 18,098

Impaired Loans

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

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

A loan is not considered impaired if:

– There is merely an insignificant delay or shortfall in the amounts of payments.

– The Company expects to collect all amounts due, including interest accrued, at the contractual interest rate for the period of the delay.

14

Table of Contents

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

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

- For loans secured by collateral including real estate and equipment the fair value of the collateral less selling costs will determine the carrying value of the loan. The difference between the recorded investment in the loan and the fair value, less selling costs, determines the amount of impairment. The Company uses the measurement method based on fair value of collateral when the loan is collateral dependent and foreclosure is probable.

- The discounted cash flow method of measuring the impairment of a loan is used for unsecured loans or for loans secured by collateral where the fair value cannot be easily determined. Under this method, the Company assesses both the amount and timing of cash flows expected from impaired loans. The estimated cash flows are discounted using the loan's effective interest rate. The difference between the amount of the loan on the Bank's books and the discounted cash flow amounts determines the amount of impairment to be provided. This method is used for most of the Company's troubled debt restructurings or other impaired loans where some payment stream is being collected.

- The observable market price method of measuring the impairment of a loan is only used by the Company when the sale of loans or a loan is in process.

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

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

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

June 30, 2012 (000's)	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment
Commercial and Business Loans	$9,929	$7,559	$2,240	$9,799	$166	$7,586
Government Program Loans	465	107	0	107	0	181
Total Commercial and Industrial	10,394	7,666	2,240	9,906	166	7,767
Commercial Real Estate Term Loans	7,971	2,780	4,922	7,702	517	7,937
Single Family Residential Loans	3,863	654	3,172	3,826	153	3,623
Home Improvement and Home Equity Loans	12	12	0	12	0	$28

Total Real Estate Mortgage	11,846	3,446	8,094	11,540	670	11,588
Total RE Construction and Development Loans	6,253	6,148	0	6,148	0	9,700
Total Agricultural Loans	999	719	0	719	0	1,524
Consumer Loans	92	89	0	89	0	127
Overdraft protection Lines	0	0	0	0	0	$0
Overdrafts	0	0	0	0	0	$0
Total Installment/other	92	89	0	89	0	127
Commercial Leases Financing	0	0	0	0	0	0
Total Impaired Loans	$29,584	$18,068	$10,334	$28,402		