

Oak Valley Bancorp
Form 10-Q
November 13, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended September 30, 2017

OR

**TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF
1934**

Commission file number 001-34142

OAK VALLEY BANCORP

(Exact name of registrant as specified in its charter)

California	26-2326676
State or other jurisdiction of incorporation or organization	I.R.S. Employer Identification No.

125 N. Third Ave., Oakdale, CA 95361

(Address of principal executive offices)

(209) 848-2265

Issuer's telephone number

Not applicable

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

Indicate by check mark whether the issuer (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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 No

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

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 definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company
(Do not check if a smaller reporting company)	Emerging growth company

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.

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

APPLICABLE ONLY TO CORPORATE ISSUERS

State the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 8,098,605 shares of common stock outstanding as of November 3, 2017.

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Oak Valley Bancorp

September 30, 2017

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PART I – FINANCIAL STATEMENTS

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Table of Contents**OAK VALLEY BANCORP****CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)**

	September 30, 2017	December 31, 2016
ASSETS		
Cash and due from banks	\$ 129,633	\$ 179,025
Federal funds sold	9,995	11,785
Cash and cash equivalents	139,628	190,810
Securities available for sale	180,857	160,333
Loans, net of allowance for loan loss of \$7,917 and \$7,832 at September 30, 2017 and December 31, 2016, respectively	626,911	601,104
Bank premises and equipment, net	13,048	13,688
Other real estate owned	253	1,210
Interest receivable and other assets	36,024	34,965
	\$ 996,721	\$ 1,002,110
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits	\$ 901,716	\$ 914,093
Interest payable and other liabilities	5,329	5,567
Total liabilities	907,045	919,660
Commitments and contingencies		
Shareholders' equity		
Common stock, no par value; 50,000,000 shares authorized, 8,098,605 and 8,088,455 shares issued and outstanding at September 30, 2017 and December 31, 2016, respectively	24,773	24,682
Additional paid-in capital	3,551	3,473
Retained earnings	60,003	54,520
Accumulated other comprehensive income (loss), net of tax	1,349	(225)
Total shareholders' equity	89,676	82,450
	\$ 996,721	\$ 1,002,110

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

Table of Contents**OAK VALLEY BANCORP****CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)**

(dollars in thousands, except per share amounts)	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2017	2016	2017	2016
INTEREST INCOME				
Interest and fees on loans	\$7,300	\$6,807	\$21,451	\$20,484
Interest on securities available for sale	1,138	1,045	3,314	3,038
Interest on federal funds sold	28	4	65	18
Interest on deposits with banks	428	169	1,100	492
Total interest income	8,894	8,025	25,930	24,032
INTEREST EXPENSE				
Deposits	274	196	773	555
Total interest expense	274	196	773	555
Net interest income	8,620	7,829	25,157	23,477
Provision for loan losses	70	90	105	415
Net interest income after provision for loan losses	8,550	7,739	25,052	23,062
OTHER INCOME				
Service charges on deposits	365	341	1,051	1,011
Earnings on cash surrender value of life insurance	130	102	386	305
Mortgage commissions	28	49	127	144
Gains on called securities	4	10	394	28
Other	749	575	2,824	1,682
Total non-interest income	1,276	1,077	4,782	3,170
OTHER EXPENSES				
Salaries and employee benefits	3,534	3,225	10,603	9,950
Occupancy expenses	823	819	2,496	2,470
Data processing fees	399	435	1,154	1,346
Regulatory assessments (FDIC & DBO)	102	178	381	505
Other operating expenses	1,202	1,267	3,708	4,027
Total non-interest expense	6,060	5,924	18,342	18,298
Net income before provision for income taxes	3,766	2,892	11,492	7,934
PROVISION FOR INCOME TAXES	1,298	962	3,987	2,591
NET INCOME	\$2,468	\$1,930	\$7,505	\$5,343

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NET INCOME PER COMMON SHARE	\$0.31	\$0.24	\$0.93	\$0.67
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NET INCOME PER DILUTED COMMON SHARE	\$0.31	\$0.24	\$0.93	\$0.66
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The accompanying notes are an integral part of these condensed consolidated financial statements.

Table of Contents**OAK VALLEY BANCORP****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)**

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
(in thousands)	2017	2016	2017	2016
Net income	\$2,468	\$1,930	\$7,505	\$5,343
Other comprehensive income:				
Unrealized gains on securities:				
Unrealized holdings gains (losses) arising during the period	39	(262)	3,069	1,723
Less: reclassification for net gains included in net income	(4)	(10)	(394)	(29)
Other comprehensive income (loss), before tax	35	(272)	2,675	1,694
Tax expense (benefit) related to items of other comprehensive income	(14)	112	(1,101)	(697)
Total other comprehensive income (loss)	21	(160)	1,574	997
Comprehensive income	\$2,489	\$1,770	\$9,079	\$6,340

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

Table of Contents**OAK VALLEY BANCORP****CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(UNAUDITED)****YEAR ENDED DECEMBER 31, 2016 AND NINE MONTHS ENDED
SEPTEMBER 30, 2017**

(dollars in thousands)	Common Shares	Stock Amount	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balances, January 1, 2016	8,078,155	\$24,682	\$ 3,217	\$48,795	\$ 1,569	\$ 78,263
Restricted stock issued	17,000					0
Restricted stock forfeited	(6,700)					0
Cash dividends declared				(1,940)		(1,940)
Stock based compensation			256			256
Other comprehensive loss					(1,794)	(1,794)
Net income				7,665		7,665
Balances, December 31, 2016	8,088,455	\$24,682	\$ 3,473	\$54,520	\$ (225)	\$ 82,450
Stock options exercised	9,000	91				91
Restricted stock issued	8,000					0
Restricted stock forfeited	(6,850)					0
Cash dividends declared				(2,022)		(2,022)
Stock based compensation			78			78
Other comprehensive income					1,574	1,574
Net income				7,505		7,505
Balances, September 30, 2017	8,098,605	\$24,773	\$ 3,551	\$60,003	\$ 1,349	\$ 89,676

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

Table of Contents**OAK VALLEY BANCORP****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**

	NINE MONTHS ENDED SEPTEMBER 30,	
(dollars in thousands)	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$7,505	\$5,343
Adjustments to reconcile net earnings to net cash from operating activities:		
Provision for loan losses	105	415
Increase (decrease) in deferred fees/costs, net	40	(29)
Depreciation	847	948
Amortization of investment securities, net	624	270
Stock based compensation	78	195
Gain on sale of premises and equipment	0	(4)
OREO (gain) loss on sales and write downs	(211)	88
Gain on sales and calls of available for sale securities	(394)	(29)
Earnings on cash surrender value of life insurance	(386)	(305)
Gain on BOLI death benefit	0	(2)
(Decrease) increase in interest payable and other liabilities	(238)	320
Decrease in interest receivable	101	52
Increase in other assets	(1,535)	(227)
Net cash from operating activities	6,536	7,035
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of available for sale securities	(41,542)	(47,182)
Proceeds from maturities, calls, and principal paydowns of securities available for sale	23,463	20,103
Net increase in loans	(25,952)	(62,895)
Purchase of FHLB Stock	(340)	(79)
Purchase of BOLI policies	0	(4,000)
Proceeds from sale of OREO	1,168	746
Proceeds from redemption of BOLI policies	0	186
Proceeds from sales of premises and equipment	0	4
Net purchases of premises and equipment	(207)	(383)
Net cash used in investing activities	(43,410)	(93,500)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Shareholder cash dividends paid	(2,022)	(1,940)
Net (decrease) increase in demand deposits and savings accounts	(8,381)	40,612
Net (decrease) increase in time deposits	(3,996)	4,453
Proceeds from sale of common stock and exercise of stock options	91	0
Net cash (used in) from financing activities	(14,308)	43,125

NET DECREASE IN CASH AND CASH EQUIVALENTS	(51,182)	(43,340)
CASH AND CASH EQUIVALENTS, beginning of period	190,810	190,603
CASH AND CASH EQUIVALENTS, end of period	\$139,628	\$147,263
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest	\$785	\$558
Income taxes	\$4,437	\$1,434
NON-CASH INVESTING ACTIVITIES:		
Real estate acquired through foreclosure	\$0	\$253
Change in unrealized gain on available-for-sale securities	\$2,675	\$1,694

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

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OAK VALLEY BANCORP

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 – BASIS OF PRESENTATION

On July 3, 2008 (the “Effective Date”), a bank holding company reorganization was completed whereby Oak Valley Bancorp (“the Company”) became the parent holding company for Oak Valley Community Bank (the “Bank”). On the Effective Date, a tax-free exchange was completed whereby each outstanding share of the Bank was converted into one share of the Company and the Company became the sole wholly-owned subsidiary of the holding company.

The consolidated financial statements include the accounts of the parent company and its wholly-owned bank subsidiary. Unless otherwise stated, the “Company” refers to the consolidated entity, Oak Valley Bancorp, while the “Bank” refers to Oak Valley Community Bank. All material intercompany transactions have been eliminated. In the opinion of Management, the consolidated financial statements contain all adjustments necessary to present fairly the financial position, results of operations, changes in shareholders’ equity and cash flows. All adjustments are of a normal, recurring nature. The interim consolidated financial statements included in this report are unaudited but reflect all adjustments which, in the opinion of management, are necessary for a fair presentation of the financial position and results of operations for the interim periods presented. All such adjustments are of a normal recurring nature. The results of operations for the three and nine month periods ended September 30, 2017 are not necessarily indicative of the results of a full year’s operations. Certain prior year amounts have been reclassified to conform to the current year presentation. There was no effect on net income or shareholders’ equity as a result of reclassifications. For further information, refer to the audited consolidated financial statements and footnotes included in the Company’s Form 10-K for the year ended December 31, 2016.

Oak Valley Community Bank is a California state-chartered bank. The Company was incorporated under the laws of the State of California on May 31, 1990, and began operations in Oakdale on May 28, 1991. The Company operates branches in Oakdale, Sonora, Bridgeport, Bishop, Mammoth Lakes, Modesto, Manteca, Patterson, Turlock, Ripon, Stockton, and Escalon, California. The Bridgeport, Mammoth Lakes, and Bishop branches operate as a separate division, Eastern Sierra Community Bank. The Company’s primary source of revenue is providing loans to customers who are predominantly middle-market businesses.

On December 23, 2015, the Company completed its acquisition of Mother Lode Bank (“MLB”), a California state-chartered bank headquartered in Sonora, California, in a transaction in which Mother Lode Bank was merged with and into the Bank, with the Bank as the surviving company in the transaction. The purchase price for Mother Lode Bank was approximately \$7.3 million.

The preparation of 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 financial statements and the reported amounts of revenues and expenses during the reporting period. Significant accounting estimates reflected in the Company's consolidated financial statements include the allowance for loan losses, accounting for income taxes, fair value measurements, and the determination, recognition and measurement of impaired loans. Actual results could differ from these estimates.

NOTE 2 – RECENT ACCOUNTING PRONOUNCEMENTS

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers (Topic 606). This ASU is a converged standard involving FASB and International Financial Reporting Standards that provides a single comprehensive revenue recognition model for all contracts with customers across transactions and industries. The core principal of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount and at a time that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Subsequent updates related to Revenue from Contracts with Customers (Topic 606) are as follows:

August 2015 ASU No. 2015-14 - Deferral of the Effective Date, institutes a one-year deferral of the effective date of this amendment to annual reporting periods beginning after December 15, 2017. Early application is permitted only as of annual periods beginning after December 15, 2016, including interim reporting periods within that reporting period.

March 2016 ASU No. 2016-08 - Principal versus Agent Considerations (Reporting Revenue Gross versus Net), clarifies the implementation guidance on principal versus agent considerations and on the use of indicators that assist an entity in determining whether it controls a specified good or service before it is transferred to the customer.

April 2016 ASU No. 2016-10 - Identifying Performance Obligations and Licensing, provides guidance in determining performance obligations in a contract with a customer and clarifies whether a promise to grant a license provides a right to access or the right to use intellectual property.

May 2016 ASU No. 2016-12 - Narrow Scope Improvements and Practical Expedients, gives further guidance on assessing collectability, presentation of sales taxes, noncash consideration, and completed contracts and contract modifications at transition.

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The adoption of this update is not expected to have a material impact on the Company's consolidated financial statements.

In September, 2015, the FASB issued ASU No. 2015-16, *Simplifying the Accounting for Measurement Period Adjustments (Topic 805)*. This ASU eliminates the requirement to restate prior period financial statements for measurement period adjustments to assets acquired and liabilities assumed in a business combination. The new guidance under this update requires the cumulative impact of measurement period adjustments be recognized in the period the adjustment is determined. This update does not change what constitutes a measurement period adjustment, nor does it change the length of the measurement period. The new standard is effective for interim annual periods beginning after December 15, 2015 and should be applied prospectively to measurement period adjustments that occur after the effective date. The adoption of this update did not have a material impact on the Company's consolidated financial statements.

In January 2016, the FASB issued ASU No. 2016-01, *Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. The amendments in this ASU make improvements to GAAP related to financial instruments that include the following as applicable to us:

Equity investments, except for those accounted for under the equity method of accounting or those that result in consolidation of the investee, are required 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.

Simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment - if impairment exists, this requires measuring the investment at fair value.

Eliminates the requirement for public companies to disclose the method(s) and significant assumptions used to estimate the fair value that is currently required to be disclosed for financial instruments measured at amortized cost on the balance sheet.

Public companies will be required to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes.

Requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements.

The reporting 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 2016-01 is effective for public business entities for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. This ASU will impact our financial statement disclosures, however, we do not expect this ASU to have a material impact on our financial condition or results of operations.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*. This ASU was issued to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities, including leases classified as operating leases under previous GAAP, on the balance sheet and requiring additional disclosures of key information about leasing arrangements. ASU 2016-02 is effective for annual periods, including interim periods within those annual periods beginning after December 15, 2018 and requires a modified retrospective approach to adoption. Early application of the amendments is permitted. While the Company has not quantified the impact to its balance sheet, it does expect the adoption of this ASU will result in a gross-up in its balance sheet as a result of recording a right-of-use asset and a lease liability for each lease, which is expected to decrease our leverage ratio by less than one percent.

In March 2016, FASB issued ASU 2016-09, *Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*. The amendments in ASU 2016-09 simplify several aspects of the accounting for share-based payment award transactions, including: (a) income tax consequences; (b) classification of awards as either equity or liabilities; and (c) classification on the statement of cash flows. The amendments are effective for public companies for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Early adoption is permitted for any interim or annual period. The Company adopted this ASU for the full fiscal year of 2016 and it did not have a significant impact on its consolidated financial statements.

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In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments – Credit Losses (Topic 326)*. This update changes the methodology used by financial institutions under current U.S. GAAP to recognize credit losses in the financial statements. Currently, U.S. GAAP requires the use of the incurred loss model, whereby financial institutions recognize in current period earnings, incurred credit losses and those inherent in the financial statements, as of the date of the balance sheet. This guidance results in a new model for estimating the allowance for loan and lease losses, commonly referred to as the Current Expected Credit Loss (“CECL”) model. Under the CECL model, financial institutions are required to estimate future credit losses and recognize those losses in current period earnings. The amendments within the update are effective for fiscal years and all interim periods beginning after December 15, 2019, with early adoption permitted. Upon adoption of the amendments within this update, the Company will be required to make a cumulative-effect adjustment to the opening balance of retained earnings in the year of adoption. The Company is currently in the process of evaluating the impact the adoption of this update will have on its financial statements. While the Company has not quantified the impact of this ASU, it does expect changing from the current incurred loss model to an expected loss model will result in an earlier recognition of losses, and an increase to our allowance for loan losses.

In August 2016, the FASB issued ASU No. 2016-15, *Statement of Cash Flows – Classification of Certain Cash Receipts and Cash Payments (Topic 230)*. This update clarifies how entities should classify certain cash receipts and cash payments on the statement of cash flows with the objective of reducing the existing diversity in practice related to eight specific cash flow issues. The amendments in this update are effective for annual periods beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted. The Company does not expect the adoption of the amendments within this update will have a material impact on the Company’s financial statements.

In January 2017, FASB issued ASU 2017-03, *Accounting Changes and Error Corrections (Topic 250) and Investments - Equity Method and Joint Ventures (Topic 323): Amendments to SEC Paragraphs Pursuant to Staff Announcements at the September 22, 2016 and November 17, 2016 EITF Meetings*. These amendments apply to ASU 2014-9 (Revenue from Contracts with Customers), ASU 2016-02 (Leases), and ASU 2016-13 (Financial Instruments - Credit Losses). The Company does not expect these amendments to have a significant impact on its consolidated financial statements.

NOTE 3 – SECURITIES

The amortized cost and estimated fair values of debt securities as of September 30, 2017 are as follows:

(dollars in thousands)	Amortized	Gross	Gross	Fair Value
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	Cost	Unrealized	Unrealized	
		Gains	Losses	
Available-for-sale securities:				
U.S. agencies	\$ 26,780	\$ 513	\$ (84	) \$27,209
Collateralized mortgage obligations	3,963	6	(29	) 3,940
Municipalities	88,026	2,677	(103	) 90,600
SBA pools	12,389	33	(15	) 12,407
Corporate debt	19,356	98	(722	) 18,732
Asset backed securities	24,727	137	(11) 24,853
Mutual fund	3,324	0	(208) 3,116
	\$ 178,565	\$ 3,464	\$ (1,172) \$180,857

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The following tables detail the gross unrealized losses and fair values aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at September 30, 2017.

(dollars in thousands)		Less than 12 months		12 months or more		Total	
		Fair	Unrealized	Fair	Unrealized	Fair	Unrealized
<u>Description of Securities</u>		Value	Loss	Value	Loss	Value	Loss
U.S. agencies		\$6,464	(72)	) \$1,841	\$ (12)	) \$8,305	\$ (84)
Collateralized mortgage obligations		1,122	(10)	) 968	(19)	) 2,090	(29)
Municipalities		10,158	(58)	) 2,879	(45)	) 13,037	(103)
SBA pools		3,812	(8)	) 716	(7)	) 4,528	(15)
Corporate debt		1,984	(16)	) 13,785	(706)	) 15,769	(722)
Asset backed securities		6,219	(9)	) 347	(2)	) 6,566	(11)
Mutual fund		0	0	) 3,116	(208)	) 3,116	(208)
Total temporarily impaired securities		\$29,759	\$ (173)	) \$23,652	\$ (999)	) \$53,411	\$ (1,172)

At September 30, 2017, there were ten corporate debts, four municipalities, two SBA pools, one U.S. agency, one collateralized mortgage obligation, one asset backed securities and one mutual fund that comprised the total securities in an unrealized loss position for greater than 12 months and twelve municipalities, five U.S. agencies, four asset backed securities, two SBA pools, one collateralized mortgage obligation, and one corporate debt that make up the total securities in a loss position for less than 12 months. 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. This evaluation encompasses various factors including, the nature of the investment, the cause of the impairment, the severity and duration of the impairment, credit ratings and other credit related factors such as third party guarantees and volatility of the security's fair value. Management has determined that no investment security is other than temporarily impaired. The unrealized losses are due primarily to interest rate changes and the Company does not intend to sell the securities and it is not likely that we will be required to sell the securities before the earlier of the forecasted recovery or the maturity of the underlying investment security.

The amortized cost and estimated fair value of investment securities at September 30, 2017, by contractual maturity or call date, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

(dollars in thousands)		Amortized Cost	Fair Value
Available-for-sale securities:			
Due in one year or less		\$ 12,724	\$ 12,981
Due after one year through five years		57,326	57,740
Due after five years through ten years		56,841	58,143

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Due after ten years	51,674	51,993
	\$ 178,565	\$ 180,857

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The amortized cost and estimated fair values of debt securities as of December 31, 2016, are as follows:

(dollars in thousands)	Amortized Cost	Gross	Gross	Fair Value
		Unrealized	Unrealized	
		Gains	Losses	
Available-for-sale securities:				
U.S. agencies	\$ 27,879	\$ 616	\$ (209)	\$ 28,286
Collateralized mortgage obligations	4,159	7	(57)	4,109
Municipalities	77,957	1,318	(946)	78,329
SBA pools	7,219	0	(51)	7,168
Corporate debt	21,349	81	(867)	20,563
Asset backed securities	18,888	32	(101)	18,819
Mutual fund	3,264	0	(205)	3,059
	\$ 160,715	\$ 2,054	\$ (2,436)	\$ 160,333

The following tables detail the gross unrealized losses and fair values aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2016.

(dollars in thousands)	Less than 12 months		12 months or more		Total	
	Fair	Unrealized	Fair	Unrealized	Fair	Unrealized
	Value	Loss	Value	Loss	Value	Loss
Description of Securities						
U.S. agencies	\$ 8,769	\$ (208)	\$ 718	\$ (1)	\$ 9,487	\$ (209)
Collateralized mortgage obligations	3,166	(57)	0	0	3,166	(57)
Municipalities	45,137	(917)	402	(29)	45,539	(946)
SBA pools	6,415	(46)	753	(5)	7,168	(51)
Corporate debt	12,776	(757)	2,884	(110)	15,660	(867)
Asset backed securities	2,576	(15)	8,272	(86)	10,848	(101)
Mutual fund	0	0	3,059	(205)	3,059	(205)
Total temporarily impaired securities	\$ 78,839	\$ (2,000)	\$ 16,088	\$ (436)	\$ 94,927	\$ (2,436)

We recognized gross gains of \$4,000 and \$394,000 for the three and nine month periods ended September 30, 2017, respectively, on certain available-for-sale securities that were called, which compares to \$10,000 and \$29,000 in the same periods of 2016. There were no securities sold during the first nine months of 2017 or 2016.

Securities carried at \$93,594,000 and \$89,362,000 at September 30, 2017 and December 31, 2016, respectively, were pledged to secure deposits of public funds.

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Our customers are primarily located in Stanislaus, San Joaquin, Tuolumne, Inyo, and Mono Counties. As of September 30, 2017, approximately 79% of the Company's loans are commercial real estate loans which include construction loans. Approximately 10% of the Company's loans are for general commercial uses including professional, retail, and small business. Additionally, 6% of the Company's loans are for residential real estate and other consumer loans. The remaining 5% are agriculture loans. Loan totals were as follows:

	September 30, 2017	December 31, 2016
Commercial real estate:		
Commercial real estate- construction	\$ 20,254	\$ 23,378
Commercial real estate- mortgages	417,253	389,495
Land	8,496	9,823
Farmland	56,670	56,159
Commercial and industrial	65,444	64,201
Consumer	607	767
Consumer residential	37,836	38,672
Agriculture	30,049	28,454
	636,609	610,949
Deferred loan fees and costs, net	(1,781)	(2,013)
Allowance for loan losses	(7,917)	(7,832)
	\$ 626,911	\$ 601,104

Loan Origination/Risk Management. The Company has certain lending policies and procedures in place that are designed to maximize loan income within an acceptable level of risk. Management reviews and approves these policies and procedures on a regular basis. A reporting system supplements the review process by providing management with frequent reports related to loan production, loan quality, concentration of credit, loan delinquencies and non-performing and potential problem loans. Diversification in the loan portfolio is a means of managing risk associated with fluctuations in economic conditions.

Commercial and industrial loans are underwritten after evaluating and understanding the borrower's ability to operate profitably and prudently expand its business. Underwriting standards are designed to promote relationship banking rather than transactional banking. Once it is determined that the borrower's management possesses sound ethics and solid business acumen, our management examines current and projected cash flows to determine the ability of the

borrower to repay their obligations as agreed. Commercial and industrial loans are primarily made based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not be as expected and the collateral securing these loans may fluctuate in value. Most commercial and industrial loans are secured by the assets being financed or other business assets such as accounts receivable or inventory and may incorporate a personal guarantee; however, some short-term loans may be made on an unsecured basis. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers.

Commercial real estate loans are subject to underwriting standards and processes similar to commercial and industrial loans, in addition to those of real estate loans. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts and the repayment of these loans is generally largely dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The properties securing the Company's commercial real estate portfolio are diverse in terms of type and geographic location. This diversity helps reduce the Company's exposure to adverse economic events that affect any single market or industry. Management monitors and evaluates commercial real estate loans based on collateral, geography and risk grade criteria. As a general rule, the Company avoids financing single-purpose projects unless other underwriting factors are present to help mitigate risk. The Company also utilizes third-party experts to provide insight and guidance about economic conditions and trends affecting market areas it serves. In addition, management tracks the level of owner-occupied commercial real estate loans versus non-owner occupied loans. At September 30, 2017 and December 31, 2016, commercial real estate loans equal to approximately 42.3% and 40.9%, respectively, of the outstanding principal balance of our commercial real estate loans were secured by owner-occupied properties.

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With respect to loans to developers and builders that are secured by non-owner occupied properties that the Company may originate from time to time, the Company generally requires the borrower to have had an existing relationship with the Company and have a proven record of success. Construction loans are underwritten utilizing feasibility studies, independent appraisal reviews, sensitivity analysis of absorption and lease rates and financial analysis of the developers and property owners. Construction loans are generally based upon estimates of costs and value associated with the complete project. These estimates may be inaccurate. Construction loans often involve the disbursement of substantial funds with repayment substantially dependent on the success of the ultimate project. Sources of repayment for these types of loans may be pre-committed permanent loans from approved long-term lenders, sales of developed property or an interim loan commitment from the Company until permanent financing is obtained. These loans are closely monitored by on-site inspections and are considered to have higher risks than other real estate loans due to their ultimate repayment being sensitive to interest rate changes, governmental regulation of real property, general economic conditions and the availability of long-term financing.

Agricultural production, real estate and development lending is susceptible to credit risks including adverse weather conditions, pest and disease, as well as market price fluctuations and foreign competition. Agricultural loan underwriting standards are maintained by following Company policies and procedures in place to minimize risk in this lending segment. These standards consist of limiting credit to experienced farmers who have demonstrated farm management capabilities, requiring cash flow projections displaying margins sufficient for repayment from normal farm operations along with equity injected as required by policy, as well as providing adequate secondary repayment and sponsorship including satisfactory collateral support. Credit enhancement obtained through government guarantee programs may also be used to provide further support as available.

The Company originates consumer loans utilizing common underwriting criteria specified in policy. To monitor and manage consumer loan risk, policies and procedures are developed and modified, as needed, jointly by line and staff personnel. This activity, coupled with relatively small loan amounts that are spread across many individual borrowers, minimizes risk. Additionally, trend and outlook reports are reviewed by management on a regular basis. Underwriting standards for 1-4 family, home equity lines and loans follow bank policy, which include, but are not limited to, a maximum loan-to-value percentage of 80%, a maximum housing and total debt ratio of 36% and 42%, respectively and other specified credit and documentation requirements.

The Company maintains an independent loan review department that reviews and validates the credit risk program on a periodic basis. Results of these reviews are presented to management. The loan review process complements and reinforces the risk identification and assessment decisions made by lenders and credit personnel, as well as the Bank's policies and procedures.

Non-Accrual and Past Due Loans. Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Loans are placed on non-accrual status when, in management's opinion, the borrower may be unable to meet payment obligations as they become due, as well as when required by regulatory provisions. Loans may be placed on non-accrual status regardless of whether or not such loans are considered past due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income

is subsequently recognized only to the extent cash payments are received in excess of principal due. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Non-accrual loans, segregated by class of loans, were as follows:

	September 30,	December 31,
(in thousands)	2017	2016
Commercial real estate:		
Commercial real estate- construction	\$ 0	\$ 0
Commercial real estate- mortgages	0	0
Land	993	2,715
Farmland	0	0
Commercial and industrial	302	306
Consumer	0	0
Consumer residential	16	16
Agriculture	0	0
Total non-accrual loans	\$ 1,311	\$ 3,037

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Excluded from the above non-accrual loan table is the \$33,000 carrying value of one Purchased Credit Impaired loan acquired in the MLB Acquisition.

Had non-accrual loans performed in accordance with their original contract terms, we would have recognized additional interest income of approximately \$27,000 and \$95,000 in the three and nine month periods ended September 30, 2017, respectively, as compared to \$38,000 and \$118,000 in the same periods of 2016.

The following table analyzes past due loans including the non-accrual loans in the above table, segregated by class of loans, as of September 30, 2017 (in thousands):

			Greater			Purchased		Greater
	30-59	60-89	Than	Total		Credit	Total	Than 90
	Days	Days	90	Past	Current	Impaired		Days
	Past	Past	Days	Due		Loans		Past Due
	Due	Due	Past					and Still
			Due					Accruing
Commercial real estate:								
Commercial R.E. - construction	\$ 0	\$ 0	\$0	\$0	\$20,254	\$ 0	\$20,254	\$ 0
Commercial R.E. - mortgages	25	0	0	25	417,228	0	417,253	0
Land	0	0	993	993	7,470	33	8,496	0
Farmland	0	0	0	0	56,670	0	56,670	0
Commercial and industrial	0	0	302	302	65,142	0	65,444	0
Consumer	0	0	0	0	607	0	607	0
Consumer residential	0	0	0	0	37,836	0	37,836	0
Agriculture	0	0	0	0	30,049	0	30,049	0
Total	\$ 25	\$ 0	\$1,295	\$1,320	\$635,256	\$ 33	\$636,609	\$ 0

The following table analyzes past due loans including the non-accrual loans in the above table, segregated by class of loans, as of December 31, 2016 (in thousands):

<u>December 31, 2016</u>	30-59	60-89	Greater	Total	Current	Purchased	Total	Greater
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	Days	Days	Than	Past		Credit		Than 90
	Past	Past	90	Due		Impaired		Days
	Due	Due	Days			Loans		Past
			Past					Due and
			Due					Still
								Accruing
Commercial real estate:								
Commercial R.E. - construction	\$ 0	\$ 0	\$0	\$0	\$23,378	\$ 0	23,378	\$ 0
Commercial R.E. - mortgages	0	0	0	0	389,495	0	389,495	0
Land	0	0	2,715	2,715	7,075	33	9,823	0
Farmland	0	0	0	0	56,159	0	56,159	0
Commercial and industrial	0	0	302	302	63,899	0	64,201	0
Consumer	0	0	0	0	767	0	767	0
Consumer residential	0	0	16	16	38,656	0	38,672	0
Agriculture	0	0	0	0	28,454	0	28,454	0
Total	\$ 0	\$ 0	\$3,033	\$3,033	\$607,883	\$ 33	610,949	