CENTRAL VALLEY COMMUNITY BANCORP
Form 10-Q
November 06, 2017
Table of Contents

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

FORM 10-Q
(Mark One)

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

FOR THE QUARTERLY PERIOD ENDED September 30, 2017

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 NUMBER: 000—31977

CENTRAL VALLEY COMMUNITY BANCORP
(Exact name of registrant as specified in its charter)

California	77-0539125
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

7100 N. Financial Dr., Suite 101, Fresno, California	93720
(Address of principal executive offices)	(Zip code)

Registrant's telephone number (559) 298-1775

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 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 ý 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 ý No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting 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 ý

Non-accelerated filer o (Do not check if a smaller reporting company)

Small 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

1

Table of Contents

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No ý
As of November 2, 2017 there were 13,581,261 shares of the registrant’s common stock outstanding.

CENTRAL VALLEY COMMUNITY BANCORP AND SUBSIDIARY

2017 QUARTERLY REPORT ON FORM 10-Q

TABLE OF CONTENTS

Table of Contents

PART 1: FINANCIAL INFORMATION

ITEM 1: FINANCIAL STATEMENTS

CENTRAL VALLEY COMMUNITY BANCORP AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
(Unaudited)

(In thousands, except share amounts)	September 30, 2017	December 31, 2016
ASSETS		
Cash and due from banks	$ 26,195	$ 28,185
Interest-earning deposits in other banks	9,494	10,368
Federal funds sold	—	15
Total cash and cash equivalents	35,689	38,568
Available-for-sale investment securities (Amortized cost of $507,477 at September 30, 2017 and $548,640 at December 31, 2016)	515,077	547,749
Loans, less allowance for credit losses of $8,916 at September 30, 2017 and $9,326 at December 31, 2016	769,810	747,302
Bank premises and equipment, net	8,920	9,407
Bank-owned life insurance	23,639	23,189
Federal Home Loan Bank stock	5,594	5,594
Goodwill	40,311	40,231
Core deposit intangibles	1,243	1,383
Accrued interest receivable and other assets	22,743	29,900
Total assets	$ 1,423,026	$ 1,443,323
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Non-interest bearing	$ 494,364	$ 495,815
Interest bearing	724,021	760,164
Total deposits	1,218,385	1,255,979
Short-term borrowings	—	400
Junior subordinated deferrable interest debentures	5,155	5,155
Accrued interest payable and other liabilities	18,254	17,756
Total liabilities	1,241,794	1,279,290
Commitments and contingencies (Note 9)		
Shareholders' equity:		
Preferred stock, no par value, $1,000 per share liquidation preference; 10,000,000 shares authorized, none issued and outstanding	—	—
Common stock, no par value; 80,000,000 shares authorized; issued and outstanding: 12,212,190 at September 30, 2017 and 12,143,815 at December 31, 2016	72,428	71,645
Retained earnings	104,399	92,904
Accumulated other comprehensive income (loss), net of tax	4,405	(516)
Total shareholders' equity	181,232	164,033
Total liabilities and shareholders' equity	$ 1,423,026	$ 1,443,323

See notes to unaudited consolidated financial statements.

4

Table of Contents

CENTRAL VALLEY COMMUNITY BANCORP AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
(In thousands, except share and per share amounts)	2017	2016	2017	2016
INTEREST INCOME:				
Interest and fees on loans	$ 10,423	$ 8,112	$ 31,287	$ 24,208
Interest on deposits in other banks	53	71	204	210
Interest and dividends on investment securities:				
Taxable	1,818	1,500	4,564	4,486
Exempt from Federal income taxes	1,531	1,582	5,428	4,680
Total interest income	13,825	11,265	41,483	33,584
INTEREST EXPENSE:				
Interest on deposits	200	240	690	690
Interest on junior subordinated deferrable interest debentures	39	30	108	88
Other	8	—	13	—
Total interest expense	247	270	811	778
Net interest income before provision for credit losses	13,578	10,995	40,672	32,806
(REVERSAL OF) PROVISION FOR CREDIT LOSSES	(900)	(1,000)	(1,150)	(5,850)
Net interest income after provision for credit losses	14,478	11,995	41,822	38,656
NON-INTEREST INCOME:				
Service charges	825	743	2,452	2,227
Appreciation in cash surrender value of bank-owned life insurance	150	131	450	411
Interchange fees	378	312	1,075	904
Net realized gains on sales of investment securities	169	286	2,808	1,836
Other-than-temporary impairment loss on investment securities	—	—	—	(136)
Federal Home Loan Bank dividends	98	110	322	314
Loan placement fees	279	347	526	792
Other income	655	206	1,263	1,005
Total non-interest income	2,554	2,135	8,896	7,353
NON-INTEREST EXPENSES:				
Salaries and employee benefits	5,989	5,608	17,865	16,304
Occupancy and equipment	1,286	1,124	3,676	3,511
Professional services	258	346	1,104	971
Data processing	407	390	1,250	1,145
Regulatory assessments	161	134	482	469
ATM/Debit card expenses	216	159	553	469
License and maintenance contracts	188	125	590	388
Directors’ expenses	135	163	492	474
Advertising	154	131	484	444
Internet banking expense	181	170	523	497
Acquisition and integration	163	363	618	515
Amortization of core deposit intangibles	47	34	141	102
Other	1,209	908	3,519	2,719
Total non-interest expenses	10,394	9,655	31,297	28,008
Income before provision for income taxes	6,638	4,475	19,421	18,001

Provision for income taxes	2,144	1,361	5,730	5,426
Net income	$4,494	$ 3,114	$13,691	$ 12,575
Earnings per common share:				
Basic earnings per share	$0.37	$ 0.28	$1.12	$ 1.15
Weighted average common shares used in basic computation	12,208,313	10,984,141	12,183,363	10,969,633
Diluted earnings per share	$0.36	$ 0.28	$1.11	$ 1.14
Weighted average common shares used in diluted computation	12,325,254	11,092,674	12,315,850	11,068,045
Cash dividend per common share	$0.06	$ 0.06	$0.18	$ 0.18

See notes to unaudited consolidated financial statements.

5

Table of Contents

CENTRAL VALLEY COMMUNITY BANCORP AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
(In thousands)	2017	2016	2017	2016
Net income	$4,494	$3,114	$13,691	$12,575
Other Comprehensive Income:				
Unrealized gains (losses) on securities:				
Unrealized holdings gains (losses) arising during the period	547	(4,453)	11,299	8,914
Less: reclassification for net gains included in net income	169	286	2,808	1,140
Less: reclassification for other-than-temporary impairment loss included in net income	—	—	—	(136)
Transfer of investment securities from held-to-maturity to available-for-sale	—	—	—	2,647
Amortization of net unrealized gains transferred	—	—	—	(64)
Other comprehensive income (loss), before tax	378	(4,739)	8,491	10,493
Tax (expense) benefit related to items of other comprehensive income	(159)	1,790	(3,570)	(4,505)
Total other comprehensive income (loss)	219	(2,949)	4,921	5,988
Comprehensive income	$4,713	$165	$18,612	$18,563

See notes to unaudited consolidated financial statements.

Table of Contents

CENTRAL VALLEY COMMUNITY BANCORP AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	For the Nine Months Ended September 30,	
(In thousands)	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$13,691	$12,575
Adjustments to reconcile net income to net cash provided by operating activities:		
Net increase (decrease) in deferred loan fees	284	(557)
Depreciation	1,019	989
Accretion	(573)	(889)
Amortization	6,469	5,769
Stock-based compensation	310	196
Excess tax benefit from exercise of stock options	—	(19)
(Reversal of) provision for credit losses	(1,150)	(5,850)
Other than temporary impairment losses on investment securities	—	136
Net realized gains on sales of available-for-sale investment securities	(2,808)	(1,140)
Net realized gains on sales of held-to-maturity securities	—	(696)
Net loss on disposal of premises and equipment	—	5
Increase in bank-owned life insurance, net of expenses	(450)	(414)
Net gain on bank-owned life insurance	—	(190)
Net decrease (increase) in accrued interest receivable and other assets	2,594	(1,240)
Net increase in accrued interest payable and other liabilities	498	2,810
Benefit (provision) for deferred income taxes	831	(977)
Net cash provided by operating activities	20,715	10,508
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of available-for-sale investment securities	(96,765)	(167,751)
Proceeds from sales or calls of available-for-sale investment securities	101,286	84,283
Proceeds from sales or calls of held-to-maturity investment securities	—	9,257
Proceeds from maturity and principal repayments of available-for-sale investment securities	33,777	39,826
Net increase in loans	(21,642)	(25,983)
Deposit on acquisition of bank	—	(9,470)
Purchases of premises and equipment	(532)	(608)
Proceeds from bank-owned life insurance	—	928
Net cash provided by (used in) investing activities	16,124	(69,518)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase (decrease) in demand, interest bearing and savings deposits	(884)	23,212
Net decrease in time deposits	(36,711)	(11,982)
Repayments of borrowings from other financial institutions	(400)	—
Proceeds from exercise of stock options	473	208
Excess tax benefit from exercise of stock options	—	19
Cash dividend payments on common stock	(2,196)	(1,986)
Net cash (used in) provided by financing activities	(39,718)	9,471
Decrease in cash and cash equivalents	(2,879)	(49,539)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	38,568	94,617
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$35,689	$45,078

(In thousands)	For the Nine Months Ended September 30, 2017	2016
SUPPLEMENTAL DISCLOSURE OF CASH FLOWS INFORMATION:		
Cash paid during the period for:		
Interest	$852	$776
Income taxes	$2,420	$4,540
Non-cash investing and financing activities:		
Transfer of securities from held-to-maturity to available-for-sale	$—	$23,131
Unrealized gain on transfer of securities from held-to-maturity to available-for-sale	$—	$526

See notes to unaudited consolidated financial statements.

Table of Contents

Note 1. Basis of Presentation

The interim unaudited condensed consolidated financial statements of Central Valley Community Bancorp and subsidiary have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC). These interim condensed consolidated financial statements include the accounts of Central Valley Community Bancorp and its wholly owned subsidiary Central Valley Community Bank (the Bank) (collectively, the Company). All significant intercompany accounts and transactions have been eliminated in consolidation. Certain information and footnote disclosures normally included in the annual consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) have been omitted. The Company believes that the disclosures are adequate to make the information presented not misleading. These interim unaudited condensed consolidated financial statements should be read in conjunction with the audited financial statements and notes thereto included in the Company's 2016 Annual Report to Shareholders on Form 10-K. In the opinion of management, all adjustments, consisting only of normal recurring adjustments, necessary to present fairly the Company's financial position at September 30, 2017, and the results of its operations for the three and nine months ended September 30, 2017 and 2016 and its cash flows for the nine month interim periods ended September 30, 2017 and 2016 have been included. The results of operations for interim periods are not necessarily indicative of results for the full year.

The preparation of these interim unaudited condensed 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 financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Management has determined that since all of the banking products and services offered by the Company are available in each branch of the Bank, all branches are located within the same economic environment, and management does not allocate resources based on the performance of different lending or transaction activities, it is appropriate to aggregate the Bank branches and report them as a single operating segment. No customer accounts for more than 10 percent of revenues for the Company or the Bank.

Impact of New Financial Accounting Standards:

FASB Accounting Standards Update (ASU) 2016-09 - Revenue from Contracts with Customers (Topic 606): Revenue from Contracts with Customers was issued in May 2014. This ASU is the result of a joint project initiated by the FASB and the International Accounting Standards Board (IASB) to clarify the principles for recognizing revenue, and to develop common revenue standards and disclosure requirements that would: (1) remove inconsistencies and weaknesses in revenue requirements; (2) provide a more robust framework for addressing revenue issues; (3) improve comparability of revenue recognition practices across entities, industries, jurisdictions, and capital markets; (4) provide more useful information to users of financial statements through improved disclosures; and (5) simplify the preparation of financial statements by reducing the number of requirements to which an entity must refer. The guidance affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets. The core principle is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance provides steps to follow to achieve the core principle. An entity should disclose sufficient information to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. Qualitative and quantitative information is required with regard to contracts with customers, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract. This ASU is effective for annual reporting periods beginning after December 15, 2017, including interim periods therein, with early adoption permitted for reporting periods beginning after December 15, 2016. The Company plans to adopt ASU 2014-09 on January 1, 2018 utilizing the modified retrospective approach. Since the guidance does not apply to revenue associated with financial instruments such as loans and investments, which are accounted for under other provisions of GAAP, we do not expect it to impact interest income, our largest component of income. The Company is currently performing an overall assessment of revenue streams potentially affected by the ASU, including certain deposit related fees and interchange fees, to determine the potential impact of this guidance on our consolidated financial statements.

FASB Accounting Standards Update (ASU) 2016-01 - Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities, was issued January 2016. The main provisions of the update are to eliminate the available-for-sale classification of accounting for equity securities and to adjust the fair value disclosures for financial instruments carried at amortized costs such that the disclosed fair values represent an exit price as opposed to an entry price. The provisions of this update will require that equity securities be carried at fair market value on the balance sheet and any periodic changes in value will be adjustments to the income statement. A practical expedient is provided for equity securities without a readily determinable fair value, such that these securities can be carried at cost less any impairment. ASU No. 2016-01 is effective for interim and annual reporting periods beginning after December 15, 2017. The Company has performed a preliminary evaluation of the provisions of ASU No. 2016-01 and based on this evaluation, has determined that ASU No. 2016-01 is not expected to have a material impact on the Company’s financial position, results of operations or its cash flows.

FASB Accounting Standards Update (ASU) 2016-02 - Leases - Overall (Subtopic 845), was issued February 2016. The update requires all leases, with the exception of short-term leases that have contractual terms of no greater than one year, to be recorded on the balance sheet. Under the provisions of the update, leases classified as operating will be reflected on the balance sheet with the recognition of both a right-of-use asset and a lease liability. Under the update, a distinction will exist between finance and operating type leases and the rules for determining which classification a lease will fall into are similar to existing rules. For public business entities, the amendments of this update are effective for interim and annual periods beginning after December 15, 2018. The update requires a modified retrospective transition under which comparative balance sheets from the earliest historical period presented will be revised to reflect what the financials would have looked like were the provisions of the update applied consistently in all prior periods. The Company is currently evaluating the provisions of ASU No. 2016-02 and has determined that the provisions of ASU No. 2016-02 will result in an increase in assets to recognize the present value of the lease obligations with a corresponding increase in liabilities; however, the Company does not expect this to have a material impact on the Company’s results of operations or cash flows.

FASB Accounting Standards Update (ASU) 2016-09 - Compensation - Stock Compensation (Subtopic 718): Improvements to Employee Share-Based Payment Accounting, was issued March 2016. This ASU includes provisions intended to simplify various aspects related to how share-based payments are accounted for and presented in the financial statements. Some of the key provisions of this new ASU include: (1) companies will no longer record excess tax benefits and certain tax deficiencies in additional paid-in capital (“APIC”). Instead, they will record all excess tax benefits and tax deficiencies as income tax expense or benefit in the income statement, and APIC pools will be eliminated. The guidance also eliminates the requirement that excess tax benefits be realized before companies can recognize them. In addition, the guidance requires companies to present excess tax benefits as an operating activity on the statement of cash flows rather than as a financing activity; (2) increase the amount an employer can withhold to cover income taxes on awards and still qualify for the exception to liability classification for shares used to satisfy the employer’s statutory income tax withholding obligation. The new guidance will also require an employer to classify the cash paid to a tax authority when shares are withheld to satisfy its statutory income tax withholding obligation as a financing activity on its statement of cash flows (current guidance did not specify how these cash flows should be classified); and (3) permit companies to make an accounting policy election for the impact of forfeitures on the recognition of expense for share-based payment awards. Forfeitures can be estimated, as required today, or recognized when they occur. ASU No. 2016-09 is effective for interim and annual reporting periods beginning after December 15, 2016. Early adoption was permitted, but all of the guidance must be adopted in the same period. Effective January 1, 2017, the Company adopted ASU 2016-09 “Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting” including the election to continue to treat option forfeitures on an expected basis and to provide cash flow disclosures on a prospective basis. During the three and nine months ended September 30, 2017 the adoption of this standard resulted in the recognition of $0 and $104,000, respectively in excess tax benefits related to the exercise of stock options during the period.

FASB Accounting Standards Update (ASU) 2016-13 - Measurement of Credit Losses on Financial Instruments (Subtopic 326): Financial Instruments - Credit Losses, commonly referred to as “CECL,” was issued June 2016. The provisions of the update eliminate the probable initial recognition threshold under current GAAP which requires reserves to be based on an incurred loss methodology. Under CECL, reserves required for financial assets measured at amortized cost will reflect an organization’s estimate of all expected credit losses over the contractual term of the financial asset and thereby require the use of reasonable and supportable forecasts to estimate future credit losses. Because CECL encompasses all financial assets carried at amortized cost, the requirement that reserves be established based on an organization’s reasonable and supportable estimate of expected credit losses extends to held to maturity

(“HTM”) debt securities. Under the provisions of the update, credit losses recognized on available for sale (“AFS”) debt securities will be presented as an allowance as opposed to a write-down. In addition, CECL will modify the accounting for purchased loans, with credit deterioration since origination, so that reserves are established at the date of acquisition for purchased loans. Under current GAAP a purchased loan’s contractual balance is adjusted to fair value through a credit discount and no reserve is recorded on the purchased loan upon acquisition. Since under CECL reserves will be established for purchased loans at the time of acquisition, the accounting for purchased loans is made more comparable to the accounting for originated loans. Finally, increased disclosure requirements under CECL require organizations to present the currently required credit quality disclosures disaggregated by the year of origination or vintage. The FASB expects that the evaluation of underwriting standards and credit quality trends by financial statement users will be enhanced with the additional vintage disclosures. For public business entities that are SEC filers, the amendments of the update will become effective beginning January 1, 2020. 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, and evaluating its current IT systems. Management expects to recognize a one-time cumulative

Table of Contents

effect adjustment to the allowance for loan losses as of the first reporting period in which the new standard is effective, but cannot yet estimate the magnitude of the one-time adjustment or the overall impact of the new guidance on the Company's financial position, results of operations or cash flows.

FASB Accounting Standards Update (ASU) 2017-04 - Intangibles Goodwill and Other (Subtopic 350): Simplifying the Test for Goodwill Impairment, was issued January 2017. The provisions of the update eliminate the existing second step of the goodwill impairment test which provides for the allocation of reporting unit fair value among existing assets and liabilities, with the net leftover amount representing the implied fair value of goodwill. In replacement of the existing goodwill impairment rule, the update will provide that impairment should be recognized as the excess of any of the reporting unit's goodwill over the fair value of the reporting unit. Under the provisions of this update, the amount of the impairment is limited to the carrying value of the reporting unit's goodwill. For public business entities that are SEC filers, the amendments of the update will become effective in fiscal years beginning after December 15, 2019.

FASB Accounting Standards Update (ASU) 2017-08 - Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities, was issued March 2017. The provisions of the update require premiums recognized upon the purchase of callable debt securities to be amortized to the earliest call date in order to avoid losses recognized upon call. For public business entities that are SEC filers, the amendments of the update will become effective in fiscal years beginning after December 15, 2018. Management does not expect the requirements of this update to have a material impact on the Company's financial position, results of operations or cash flows.

FASB Accounting Standards Update (ASU) 2017-09 - Compensation - Stock Compensation (Subtopic 718): Scope of Modification Accounting, was issued May 2017. The amendments in ASU 2017-09 provide guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting. An entity should account for the effects of a modification unless all of the following conditions are met: the fair value of the modified award is the same as the fair value of the original award immediately before the original award is modified; the vesting conditions of the modified award are the same as the vesting conditions of the original award immediately before the original award is modified; and the classification of the modified award as an equity instrument or a liability instrument is the same as the classification of the original award immediately before the original award is modified. The amendments in this Update should be applied prospectively to an award modified on or after the adoption date. The amendments in this Update are effective for annual periods, and interim periods within those annual periods, beginning after December 31, 2017. Early adoption is permitted, including adoption in any interim period. The adoption of this guidance is not expected to have a material impact on the Company's Consolidated Financial Statements.

FASB Accounting Standards Update (ASU) 2017-12 - Derivatives and Hedging (Topic 815); Targeted Improvements to Accounting for Hedging Activities was issued August 2017. This ASU's objectives are to (1) improve the transparency and understandability of information conveyed to financial statement users about an entity's risk management activities by better aligning the entity's financial reporting for hedging relationships with those risk management activities; and (2) reduce the complexity of and simplify the application of hedge accounting by preparers. ASU No. 2017-12 is effective for interim and annual reporting periods beginning after December 15, 2018; early adoption is permitted. The Company currently does not designate any derivative financial instruments as formal hedging relationships, and therefore, does not utilize hedge accounting. However, the Company is currently evaluating this ASU to determine whether its provisions will enhance the Company's ability to employ risk management strategies, while improving the transparency and understanding of those strategies for financial statement users.

Note 2. ACQUISITIONS

Effective October 1, 2016, the Company acquired Sierra Vista Bank, headquartered in Folsom, California, wherein Sierra Vista Bank, with one branch in Folsom, one branch in Fair Oaks, and one branch in Cameron Park, merged with and into the Bank. Sierra Vista Bank’s assets as of October 1, 2016 totaled approximately $155.154 million. The acquired assets and liabilities were recorded at fair value at the date of acquisition. Under the terms of the merger agreement, the Company issued an aggregate of approximately 1.059 million shares of its common stock and cash totaling approximately $9.469 million to the former shareholders of Sierra Vista Bank.

In accordance with GAAP guidance for business combinations, the Company recorded $10.314 million of goodwill and $508,000 of other intangible assets on the acquisition date. The other intangible assets are primarily related to core deposits and are being amortized using a straight-line method over a period of ten years with no significant residual value. For tax purposes, purchase accounting adjustments including goodwill are all non-taxable and/or non-deductible. The fair values of assets acquired and liabilities assumed are subject to adjustment during the first twelve months after the acquisition date if additional information becomes available to indicate a more accurate or appropriate value for an asset or liability. During the

Table of Contents

nine-month period ended September 30, 2017, the Company determined that a measurement adjustment was appropriate which resulted in an $80,000 increase to goodwill.
The acquisition was consistent with the Company's strategy to build a regional presence in Central California. The acquisition offers the Company the opportunity to increase profitability by introducing existing products and services to the acquired customer base as well as add new customers in the expanded region. Goodwill arising from the acquisition consisted largely of synergies and the cost savings resulting from the combined operations.

Pro Forma Results of Operations

The following table presents pro forma results of operations information for the periods presented as if the acquisition had occurred on January 1, 2016 after giving effect to certain adjustments. The unaudited pro forma results of operations for the nine months ended September 30, 2016 include the historical accounts of the Company and Sierra Vista Bank and pro forma adjustments as may be required, including the amortization of intangibles with definite lives and the amortization or accretion of any premiums or discounts arising from fair value adjustments for assets acquired and liabilities assumed. The pro forma information is intended for informational purposes only and is not necessarily indicative of the Company's future operating results or operating results that would have occurred had the acquisition been completed at the beginning of 2016. No assumptions have been applied to the pro forma results of operations regarding possible revenue enhancements, expense efficiencies or asset dispositions. (In thousands, except per-share amounts):

Pro Forma Results of Operations	For the Nine Months Ended September 30,	
(In thousands, except per share amounts)	2016	
Net interest income	$	37,741
(Reversal of) Provision for credit losses	(5,750	)
Non-interest income	7,692	
Non-interest expense	36,449	
Income before provision for income taxes	14,734	
Provision for income taxes	4,326	
Net income	$	10,408
Basic earnings per common share	$	0.95
Diluted earnings per common share	$	0.94

On October 1, 2017, the Company completed the acquisition of Folsom Lake Bank ("Folsom") for an aggregate transaction value of $28.5 million. Folsom was merged into the Bank, and the Company issued 1,276,888 shares of common stock to the former shareholders of Folsom. The Company also assumed the outstanding Folsom stock options. Folsom operated three full-service branches in Folsom, Rancho Cordova, and Roseville, California. Folsom's assets (unaudited) as of September 30, 2017 totaled approximately $197.3 million. The acquired assets and liabilities will be recorded at fair value at the date of acquisition and will be reflected in the Company's December 31, 2017 financial statements. The Company also expects to record goodwill and a core deposit intangible related to this transaction, but those amounts are not yet known as the initial fair value accounting is incomplete. The goodwill will not be deductible for tax purposes.

Table of Contents

Note 3. Fair Value Measurements

Fair Value Hierarchy

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. In accordance with applicable guidance, the Company groups its assets and liabilities measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. Valuations within these levels are based upon:

Level 1 — Quoted market prices (unadjusted) for identical instruments traded in active exchange markets that the Company has the ability to access as of the measurement date.

Level 2 — Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable or can be corroborated by observable market data.

Level 3 — Model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect the Company's estimates of assumptions that market participants would use on pricing the asset or liability. Valuation techniques include management judgment and estimation which may be significant.

Management monitors the availability of observable market data to assess the appropriate classification of financial instruments within the fair value hierarchy. Changes in economic conditions or model-based valuation techniques may require the transfer of financial instruments from one fair value level to another. In such instances, we report the transfer at the beginning of the reporting period. The estimated carrying and fair values of the Company's financial instruments are as follows (in thousands):

	September 30, 2017				
	Carrying	Fair Value			
(In thousands)	Amount	Level 1	Level 2	Level 3	Total
Financial assets:					
Cash and due from banks	$26,195	$26,195	$ —	$ —	$ 26,195
Interest-earning deposits in other banks	9,494	9,494	—	—	9,494
Federal funds sold	—	—	—	—	—
Available-for-sale investment securities	515,077	7,486	507,591	—	515,077
Loans, net	769,810	—	—	781,683	781,683
Federal Home Loan Bank stock	5,594	N/A	N/A	N/A	N/A
Accrued interest receivable	6,345	19	3,138	3,188	6,345
Financial liabilities:					
Deposits	1,218,385	1,097,742	119,843	—	1,217,585
Junior subordinated deferrable interest debentures	5,155	—	—	3,400	3,400
Accrued interest payable	103	—	64	39	103

Table of Contents

	December 31, 2016				
	Carrying	Fair Value			
(In thousands)	Amount	Level 1	Level 2	Level 3	Total
Financial assets:					
Cash and due from banks	$28,185	$28,185	$ —	$ —	$ 28,185
Interest-earning deposits in other banks	10,368	10,368	—	—	10,368
Federal funds sold	15	15	—	—	15
Available-for-sale investment securities	547,749	7,416	540,333	—	547,749
Loans, net	747,302	—	—	761,023	761,023
Federal Home Loan Bank stock	5,594	N/A	N/A	N/A	N/A
Accrued interest receivable	7,885	26	4,517	3,342	7,885
Financial liabilities:					
Deposits	1,255,979	1,099,200	156,711	—	1,255,911
Short-term borrowings	400	—	400	—	400
Junior subordinated deferrable interest debentures	5,155	—	—	3,235	3,235
Accrued interest payable	144	—	111	33	144

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. These estimates are made at a specific point in time based on relevant market data and information about the financial instruments. 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.
The methods and assumptions used to estimate fair values are described as follows:

(a) Cash and Cash Equivalents — The carrying amounts of cash and due from banks, interest-earning deposits in other banks, and Federal funds sold approximate fair values and are classified as Level 1.

(b) Investment Securities — Investment securities in Level 1 are mutual funds and fair values are based on quoted market prices for identical instruments traded in active markets. Fair values for investment securities classified in Level 2 are based on quoted market prices for similar securities in active markets. For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators.

(c) Loans — Fair values of loans 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. Purchased credit impaired (PCI) loans are measured at estimated fair value on the date of acquisition. Carrying value is calculated as the present value of expected cash flows and approximates fair value. 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 resulting in a Level 3 classification. Impaired loans are initially valued at the lower of cost or fair value. Impaired loans carried at fair value generally receive specific allocations of the allowance for credit losses. For collateral dependent real estate loans, fair value is commonly based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales 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 data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business, resulting in a Level 3 fair value classification. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly. The methods utilized to estimate the fair value of loans do not necessarily represent an exit price.

(d) FHLB Stock — It is not practicable to determine the fair value of FHLB stock due to restrictions placed on its transferability.

Table of Contents

(e) Other real estate owned — OREO is measured at fair value less estimated costs to sell when acquired, establishing a new cost basis. Fair value is commonly based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process to adjust for differences between the comparable sales and income data available. The Company records OREO as non-recurring with level 3 measurement inputs.

(f) Deposits — Fair value of demand deposit, savings, and 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. Fair value for fixed and variable rate certificates of deposit are estimated using discounted cash flow analyses using interest rates offered at each reporting date by the Company for certificates with similar remaining maturities resulting in a Level 2 classification.

(g) Short-Term Borrowings — The fair values of the Company's federal funds purchased, borrowings under repurchase agreements, and other short-term borrowings, generally maturing within ninety days, are based on the market rates for similar types of borrowing arrangements resulting in a Level 2 classification.

(h) Other Borrowings — The fair values of the Company's long-term borrowings are estimated using discounted cash flow analyses based on the current borrowing rates for similar types of borrowing arrangements resulting in a Level 2 classification.

The fair values of the Company's Subordinated Debentures are estimated using discounted cash flow analyses based on the current borrowing rates for similar types of borrowing arrangements resulting in a Level 3 classification.

(i) Accrued Interest Receivable/Payable — The fair value of accrued interest receivable and payable is based on the fair value hierarchy of the related asset or liability.

(j) 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 is not considered significant for financial reporting purposes.

Assets Recorded at Fair Value

The following tables present information about the Company's assets and liabilities measured at fair value on a recurring and non-recurring basis as of September 30, 2017:

Recurring Basis

The Company is required or permitted to record the following assets at fair value on a recurring basis as of September 30, 2017 (in thousands).

Description	Fair Value	Level 1	Level 2	Level 3
Available-for-sale securities				
Debt Securities:				
U.S. Government agencies	$61,804	$—	$61,804	$ —
Obligations of states and political subdivisions	212,985	—	212,985	—
U.S. Government sponsored entities and agencies collateralized by residential mortgage obligations	188,349	—	188,349	—
Private label residential mortgage backed securities	44,453	—	44,453	—

Other equity securities	7,486	7,486	—	—
Total assets measured at fair value on a recurring basis	$515,077	$7,486	$507,591	$ —

Securities in Level 1 are mutual funds and fair values are based on quoted market prices for identical instruments traded in active markets. Fair values for available-for-sale investment securities in Level 2 are based on quoted market prices for similar securities in active markets. For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators. Management evaluates the significance of transfers between levels based upon the nature of the financial instrument and size of the transfer relative to total assets, total liabilities or total earnings. During the nine months ended September 30, 2017, no transfers between levels occurred.

Table of Contents

There were no Level 3 assets measured at fair value on a recurring basis at or during the nine months ended September 30, 2017. Also there were no liabilities measured at fair value on a recurring basis at September 30, 2017.

Non-recurring Basis

The Company may be required, from time to time, to measure certain assets and liabilities at fair value on a non-recurring basis. These include assets and liabilities that are measured at the lower of cost or fair value that were recognized at fair value which was below cost at September 30, 2017 (in thousands).

Description	Fair Value	Level 1	Level 2	Level 3
Consumer:				
Equity loans and lines of credit	$ 16	$ —	$ —	$ 16
Total impaired loans	16	—	—	16
Other repossessed assets	$ 194	$ —	$ —	$ 194
Other real estate owned	—	—	—	—
Total assets measured at fair value on a non-recurring basis	$ 210	$ —	$ —	$ 210

At the time a loan is considered impaired, it is valued at the lower of cost or fair value. Impaired loans carried at fair value generally receive specific allocations of the allowance for credit losses. For collateral dependent real estate loans, fair value is commonly based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales 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 data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business, resulting in a Level 3 fair value classification. The fair value of impaired loans is based on the fair value of the collateral. Impaired loans were determined to be collateral dependent and categorized as Level 3 due to ongoing real estate market conditions resulting in inactive market data, which in turn required the use of unobservable inputs and assumptions in fair value measurements. Impaired loans evaluated under the discounted cash flow method are excluded from the table above. The discounted cash flow methods as prescribed by ASC Topic 310 is not a fair value measurement since the discount rate utilized is the loan's effective interest rate which is not a market rate. There were no changes in valuation techniques used during the nine month period ended September 30, 2017.

Appraisals for collateral-dependent impaired loans are performed by certified general appraisers (for commercial properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been reviewed and verified by the Company. Once received, the assumptions and approaches utilized in the appraisal as well as the overall resulting fair value is compared with independent data sources such as recent market data or industry-wide statistics.

Impaired loans that are measured for impairment using the fair value of the collateral for collateral dependent loans, had a principal balance of $45,000 with a valuation allowance of $29,000 at September 30, 2017, resulting in fair value of $16,000. The valuation allowance represent specific allocation for the allowance for credit losses for impaired loans.

There were no charge-offs related to loans carried at fair value during the nine months ended September 30, 2017 and 2016. Activity related to changes in the allowance for loan losses related to impaired loans for the three months ended September 30, 2017 and 2016 was not considered significant for disclosure purposes. At September 30, 2017, other repossessed assets were recorded at their estimated fair value of $194,000. Write downs related to other repossessed assets for the three and nine months ended September 30, 2017 and 2016 were not significant for disclosure purposes. There were no liabilities measured at fair value on a non-recurring basis at September 30, 2017.

Table of Contents

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, 2016:

Recurring Basis

The Company is required or permitted to record the following assets at fair value on a recurring basis as of December 31, 2016 (in thousands).

Description	Fair Value	Level 1	Level 2	Level 3
Available-for-sale securities				
Debt Securities:				
U.S. Government agencies	$ 68,970	$ —	$ 68,970	$ —
Obligations of states and political subdivisions	290,299	—	290,299	—
U.S. Government sponsored entities and agencies collateralized by residential mortgage obligations	178,221	—	178,221	—
Private label residential mortgage backed securities	2,843	—	2,843	—
Other equity securities	7,416	7,416	—	—
Total assets measured at fair value on a recurring basis	$ 547,749	$ 7,416	$ 540,333	$ —

Securities in Level 1 are mutual funds and fair values are based on quoted market prices for identical instruments traded in active markets. Fair values for available-for-sale investment securities in Level 2 are based on quoted market prices for similar securities in active markets. For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators.

Management evaluates the significance of transfers between levels based upon the nature of the financial instrument and size of the transfer relative to total assets, total liabilities or total earnings. During the year ended December 31, 2016, no transfers between levels occurred.

There were no Level 3 assets measured at fair value on a recurring basis at or during the year ended December 31, 2016. Also there were no liabilities measured at fair value on a recurring basis at December 31, 2016.

Non-recurring Basis

The Company may be required, from time to time, to measure certain assets and liabilities at fair value on a non-recurring basis. These include assets and liabilities that are measured at the lower of cost or fair value that were recognized at fair value which was below cost at December 31, 2016 (in thousands).

Description	Fair Value	Level 1	Level 2	Level 3
Impaired loans:				
Consumer:				
Equity loans and lines of credit	$ 47	$ —	$ —	$ 47
Total impaired loans	47	—	—	47
Other repossessed assets	362	—	—	362
Total assets measured at fair value on a non-recurring basis	$ 409	$ —	$ —	$ 409

At the time a loan is considered impaired, it is valued at the lower of cost or fair value. Impaired loans carried at fair value generally receive specific allocations of the allowance for credit losses. For collateral dependent loans, fair value is commonly based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales 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 data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business, resulting in a Level 3 fair value classification. The fair value of impaired loans is based on the fair value of the collateral. Impaired loans were determined to be collateral dependent and categorized as Level 3 due to ongoing real estate market conditions resulting in inactive market data, which in turn required the use of unobservable inputs and assumptions in fair value measurements. Impaired loans evaluated under the discounted cash flow method are excluded from the table above. The discounted cash flow method as prescribed by ASC Topic

Table of Contents

310 is not a fair value measurement since the discount rate utilized is the loan's effective interest rate which is not a market rate. There were no changes in valuation techniques used during the year ended December 31, 2016. Appraisals for collateral-dependent impaired loans are performed by certified general appraisers (for commercial properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been reviewed and verified by the Company. Once received, the assumptions and approaches utilized in the appraisal as well as the overall resulting fair value is compared with independent data sources such as recent market data or industry-wide statistics.

Impaired loans that are measured for impairment using the fair value of the collateral for collateral dependent loans, had a principal balance of $62,000 with a valuation allowance of $15,000 at December 31, 2016, resulting in fair value of $47,000. The valuation allowance represents specific allocations for the allowance for credit losses for impaired loans.

During the year ended December 31, 2016 specific allocation for the allowance for credit losses related to loans carried at fair value was $15,000. During the year ended December 31, 2016, there was no net charge-offs related to loans carried at fair value.

There were no liabilities measured at fair value on a non-recurring basis at December 31, 2016.

Note 4. Investments

The investment portfolio consists primarily of U.S. Government sponsored entity and agency securities collateralized by residential mortgage obligations, private label residential mortgage backed securities (PLRMBS), and obligations of states and political subdivisions securities. As of September 30, 2017, $96,042,000 of these securities were held as collateral for borrowing arrangements, public funds, and for other purposes.

The fair value of the available-for-sale investment portfolio reflected a net unrealized gain of $7,600,000 at September 30, 2017 compared to an unrealized loss of $891,000 at December 31, 2016. The unrealized gain recorded is net of $3,195,000 and $(375,000) in tax liabilities (benefits) as accumulated other comprehensive income within shareholders' equity at September 30, 2017 and December 31, 2016, respectively.

The following table sets forth the carrying values and estimated fair values of our investment securities portfolio at the dates indicated (in thousands):

	September 30, 2017			
Available-for-Sale Securities	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Government agencies	$61,253	$ 598	$ (47)	$ 61,804
Obligations of states and political subdivisions	204,841	8,660	(516)	212,985
U.S. Government sponsored entities and agencies collateralized by residential mortgage obligations	190,028	696	(2,375)	188,349
Private label mortgage backed securities	43,855	977	(379)	44,453
Other equity securities	7,500	—	(14)	7,486
Total available-for-sale	$507,477	$ 10,931	$ (3,331)	$ 515,077

	December 31, 2016			
Available-for-Sale Securities	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Government agencies	$69,005	$ 242	$ (277)	$ 68,970
Obligations of states and political subdivisions	288,543	6,109	(4,353)	290,299
U.S. Government sponsored entities and agencies collateralized by residential mortgage obligations	181,785	484	(4,048)	178,221

Private label mortgage backed securities	1,807	1,036	—	2,843
Other equity securities	7,500	—	(84)	7,416
Total available-for-sale	$548,640	$ 7,871	$ (8,762)	$ 547,749

Table of Contents

Proceeds and gross realized gains (losses) from the sales or calls of investment securities for the periods ended September 30, 2017 and 2016 are shown below (in thousands):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
Available-for-Sale Securities	2017	2016	2017	2016
Proceeds from sales or calls	$26,286	$21,239	$101,293	$84,283
Gross realized gains from sales or calls	210	306	3,601	1,277
Gross realized losses from sales or calls	(41)	(20)	(793)	(137)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
Held-to-Maturity Securities	2017	2016	2017	2016
Proceeds from sales or calls	$ —	$ —	$ —	$ 9,257
Gross realized gains from sales or calls	—	—	—	696

During 2014, to better manage our interest rate risk, the Company transferred from available-for-sale to held-to-maturity selected municipal securities in our portfolio having a book value of approximately $31 million, a market value of approximately $32 million, and a net unrecognized gain of approximately $163,000. During the first quarter of 2016, the Company sold certain investment securities of which the Company identified that five of the 13 securities sold were previously designated as held-to-maturity (HTM). Through an oversight during the portfolio restructuring analysis related to this transaction, the Company unintentionally sold these five HTM securities. The book value of the HTM securities sold was $8.5 million. The gain realized on the sale of the HTM securities was $696,000. As such, the Company was required to reclassify the remaining HTM securities with a fair value of $23.1 million to the available-for-sale designation.

Losses recognized in 2017 and 2016 were incurred in order to reposition the investment securities portfolio based on the current rate environment. The securities which were sold at a loss were acquired when the rate environment was not as volatile. As market interest rates or risks associated with a security's issuer continue to change and impact the actual or perceived values of investment securities, the Company may determine that selling these securities and using proceeds to purchase securities that fit with the Company's current risk profile is appropriate and beneficial to the Company.

The provision for income taxes includes $1,181,000 and $479,000 income tax impact from the reclassification of unrealized net gains on securities to realized net gains on securities for the nine months ended September 30, 2017 and 2016, respectively. The provision for income taxes includes $71,000 and $120,000 income tax impact from the reclassification of unrealized net gains on available-for-sale securities to realized net gains on available-for-sale securities for the three months ended September 30, 2017 and 2016, respectively.

Investment securities, aggregated by investment category, with unrealized losses as of the dates indicated are summarized and classified according to the duration of the loss period as follows (in thousands):

	September 30, 2017					
	Less than 12 Months		12 Months or More		Total	
Available-for-Sale Securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Debt securities:						
U.S. Government agencies	$—	$ —	$7,272	$ (47)	$7,272	$ (47)
Obligations of states and political subdivisions	8,239	(65)	18,216	(451)	26,455	(516)

U.S. Government sponsored entities and agencies collateralized by residential mortgage obligations	54,089	(199)	66,868	(2,176)	120,957	(2,375)
Private label mortgage backed securities	41,941	(379)	—	—	41,941	(379)
Other equity securities	7,486	(14)	—	—	7,486	(14)
Total available-for-sale	$111,755	$ (657)	$92,356	$ (2,674)	$204,111	$ (3,331)

Table of Contents

	December 31, 2016					
	Less than 12 Months		12 Months or More		Total	
Available-for-Sale Securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Debt securities:						
U.S. Government agencies	$34,586	$ (198)	$ 10,438	$ (79)	$45,024	$ (277)
Obligations of states and political subdivisions	122,522	(4,353)	—	—	122,522	(4,353)
U.S. Government sponsored entities and agencies collateralized by residential mortgage obligations	118,719	(3,866)	7,666	(182)	126,385	(4,048)
Other equity securities	7,416	(84)	—	—	7,416	(84)
Total available-for-sale	$283,243	$ (8,501)	$ 18,104	$ (261)	$301,347	$ (8,762)

The Company periodically evaluates each investment security for other-than-temporary impairment, relying primarily on industry analyst reports, observation of market conditions and interest rate fluctuations. The portion of the impairment that is attributable to a shortage in the present value of expected future cash flows relative to the amortized cost should be recorded as a current period charge to earnings. The discount rate in this analysis is the original yield expected at time of purchase.

As of September 30, 2017, the Company performed an analysis of the investment portfolio to determine whether any of the investments held in the portfolio had an other-than-temporary impairment (OTTI). The Company evaluated all individual available-for-sale investment securities with an unrealized loss at September 30, 2017 and identified those that had an unrealized loss for at least a consecutive 12 month period, which had an unrealized loss at September 30, 2017 greater than 10% of the recorded book value on that date, or which had an unrealized loss of more than $10,000. The Company also analyzed any securities that may have been downgraded by credit rating agencies. For those bonds that met the evaluation criteria, management obtained and reviewed the most recently published national credit ratings for those bonds. For those bonds that were obligations of states and political subdivisions with an investment grade rating by the rating agencies, the Company also evaluated the financial condition of the municipality and any applicable municipal bond insurance provider and concluded during March 2016 that a $136,000 credit related impairment related to one security with a fair value of $2,995,000 and a pre-impairment amortized cost of $3,131,000 existed. The Company recorded an other-than-temporary impairment loss of $136,000 during the nine months ended September 30, 2016. There were no OTTI losses recorded during the nine months ended September 30, 2017. There were no OTTI losses recorded during the three months ended September 30, 2016.

U.S. Government Agencies

At September 30, 2017, the Company held 21 U.S. Government agency securities, of which none were in a loss position for less than 12 months and two were in a loss position or had been in a loss position for 12 months or more. The unrealized losses on the Company’s investments in direct obligations of U.S. government agencies were caused by interest rate changes. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized costs of the investment. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company has the ability and intent to hold, and it is more likely than not that it will not be required to sell, those investments until a recovery of fair value, which may be the maturity date, the Company does not consider those investments to be other-than-temporarily impaired at September 30, 2017.

Obligations of States and Political Subdivisions

At September 30, 2017, the Company held 122 obligations of states and political subdivision securities of which two were in a loss position for less than 12 months and six were in a loss position or had been in a loss position for 12 months or more. The unrealized losses on the Company’s investments in obligations of states and political subdivision securities were caused by interest rate changes. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company has the ability to hold and does not intend to sell, and it is more likely than not that it will not be required to sell those investments until a recovery of fair value, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at September 30, 2017.

U.S. Government Sponsored Entities and Agencies Collateralized by Residential Mortgage Obligations

At September 30, 2017, the Company held 142 U.S. Government sponsored entity and agency securities collateralized by residential mortgage obligations of which 23 were in a loss position for less than 12 months and 26 have been in a loss

Table of Contents

position for more than 12 months. The unrealized losses on the Company's investments in U.S. Government sponsored entities and agencies collateralized by residential mortgage obligations were caused by interest rate changes. The contractual cash flows of those investments are guaranteed by an agency or sponsored entity of the U.S. Government. Accordingly, it is expected that the securities would not be settled at a price less than the amortized cost of the Company's investment. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company has the ability to hold and does not intend to sell, and it is more likely than not that it will not be required to sell those investments until a recovery of fair value, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at September 30, 2017.

Private Label Mortgage Backed Securities

At September 30, 2017, the Company had a total of 22 PLMBS with a remaining principal balance of $43,855,000 and a net unrealized gain of approximately $599,000. Ten of these PLMBS with a remaining principal balance of $1,431,000 had credit ratings below investment grade. Eight of the PLMBS securities were in a loss position for less than 12 months at September 30, 2017. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company has the ability and intent to hold, and it is more likely than not that it will not be required to sell, those investments until a recovery of fair value, which may be the maturity date, the Company does not consider those investments to be other-than-temporarily impaired at September 30, 2017. The Company continues to monitor these securities for indications that declines in value, if any, may be other-than-temporary.

Other Equity Securities

At September 30, 2017, the Company had one mutual fund equity investment which had an unrealized loss of $14,000 at September 30, 2017. The equity investment was in a loss position for less than 12 months at September 30, 2017.

The following tables provide a roll forward for the nine month periods ended September 30, 2017 and 2016 of investment securities credit losses recorded in earnings. The beginning balance represents the credit loss component for which OTTI occurred on debt securities in prior periods. Additions represent the first time a debt security was credit impaired or when subsequent credit impairments have occurred on securities for which OTTI credit losses have been previously recognized.

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
(In thousands)	2017	2016	2017	2016
Beginning balance	$874	$883	$874	$747
Amounts related to credit loss for which an OTTI charge was not previously recognized	—	—	—	136
Increases to the amount related to credit loss for which OTTI was previously recognized	—	—	—	—
Realized gain for securities sold	—	(9)	—	(9)
Ending balance	$874	$874	$874	$874

The amortized cost and estimated fair value of available-for-sale investment securities at September 30, 2017 by contractual maturity is shown below (in thousands). 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.

20

Table of Contents

	September 30, 2017	
Available-for-Sale Securities	Amortized Cost	Estimated Fair Value
Within one year	$1,532	$ 1,557
After one year through five years	6,294	6,523
After five years through ten years	31,333	32,336
After ten years	165,682	172,569
	204,841	212,985
Investment securities not due at a single maturity date:		
U.S. Government agencies	61,253	61,804
U.S. Government sponsored entities and agencies collateralized by residential mortgage obligations	190,028	188,349
Private label mortgage backed securities	43,855	44,453
Other equity securities	7,500	7,486
Total available-for-sale	$507,477	$ 515,077

Note 5. Loans and Allowance for Credit Losses

Outstanding loans are summarized as follows:

Loan Type (Dollars in thousands)	September 30, 2017	% of Total Loans	December 31, 2016	% of Total Loans
Commercial:				
Commercial and industrial	$ 90,511	11.6 %	$ 88,652	11.7 %
Agricultural land and production	18,074	2.4 %	25,509	3.4 %
Total commercial	108,585	14.0 %	114,161	15.1 %
Real estate:				
Owner occupied	191,918	24.6 %	191,665	25.3 %
Real estate construction and other land loans	84,135	10.8 %	69,200	9.1 %
Commercial real estate	212,008	27.2 %	184,225	24.3 %
Agricultural real estate	72,082	9.3 %	86,761	11.5 %
Other real estate	19,572	2.6 %	18,945	2.7 %
Total real estate	579,715	74.5 %	550,796	72.9 %
Consumer:				
Equity loans and lines of credit	61,822	8.0 %	64,494	8.5 %
Consumer and installment	27,595	3.5 %	25,910	3.5 %
Total consumer	89,417	11.5 %	90,404	12.0 %
Net deferred origination costs	1,009		1,267	
Total gross loans	778,726	100.0 %	756,628	100.0 %
Allowance for credit losses	(8,916)		(9,326)	
Total loans	$ 769,810		$ 747,302	

At September 30, 2017 and December 31, 2016, loans originated under Small Business Administration (SBA) programs totaling $24,569,000 and $16,590,000, respectively, were included in the real estate and commercial categories, of which, $18,170,000 or 74% and $12,188,000 or 73%, respectively, are secured by government guarantees.

Purchased Credit Impaired Loans

The Company has loans that were acquired in acquisitions for which there was at acquisition evidence of deterioration of credit quality since origination, and for which it was probable at acquisition that all contractually required payments would not be collected.
The carrying amount of those loans is included in the balance sheet amounts of loans receivable at September 30, 2017 and December 31, 2016. The amounts of loans at September 30, 2017 and December 31, 2016 are as follows (in thousands):

Table of Contents

	September 30, 2017	December 31, 2016
Commercial	$ 404	$ 612
Outstanding balance	$ 404	$ 612
Carrying amount, net of allowance of $0	$ 404	$ 612

Purchased credit impaired (PCI) loans are recorded at the amount paid, such that there is no carryover of the seller's allowance for loan losses. The Company estimates the amount and timing of expected cash flows for each loan and the expected cash flows in excess of amount paid is recorded as interest income over the remaining life of the loan (accretable yield). The excess of the loan's contractual principal and interest over expected cash flows is not recorded (nonaccretable difference). Over the life of the loan expected cash flows continue to be estimated. If the present value of expected cash flows is less than the carrying amount, a loss is recorded. If the present value of expected cash flows is greater than the carrying amount, it is recognized as part of future interest income.

Loans acquired during each year for which it was probable at acquisition that all contractually required payments would not be collected are as follows (in thousands):

	September 30, 2017	December 31, 2016
Contractually required payments receivable on PCI loans at acquisition:		
Commercial	$ —	$ 982
Total	$ —	$ 982
Cash flows expected to be collected at acquisition	$ —	$ 693
Fair value of acquired loans at acquisition	$ —	$ 631

Certain of the loans acquired by the Company that are within the scope of Topic ASC 310-30 are not accounted for using the income recognition model of the Topic because the Company cannot reliably estimate cash flows expected to be collected. The carrying amounts of such loans (which are included in the carrying amount, net of allowance, described above) are as follows.

	September 30, 2017	December 31, 2016
Loans acquired during the year	$ —	$ 631
Loans at the end of the period	$ 404	$ 612

Allowance for Credit Losses

The allowance for credit losses (the "Allowance") is a valuation allowance for probable incurred credit losses in the Company's loan portfolio. The Allowance is established through a provision for credit 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 credits is recorded as a recovery to the Allowance. The overall Allowance consists of two primary components, specific reserves related to impaired loans and general reserves for probable incurred losses related to loans that are not impaired.

For all portfolio segments, the determination of the general reserve for loans that are not impaired is based on estimates made by management, including but not limited to, consideration of historical losses by portfolio segment (and in certain cases peer data) over the most recent 20 quarters, and qualitative factors including 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 loan portfolio, and probable losses inherent in the portfolio taken as a whole.

Table of Contents

The following table shows the summary of activities for the Allowance as of and for the three months ended September 30, 2017 and 2016 by portfolio segment (in thousands):

	Commercial	Real Estate	Consumer	Unallocated	Total
Allowance for credit losses:					
Beginning balance, July 01, 2017	$ 2,196	$ 5,931	$ 793	$ 377	$9,297
(Reversal) provision charged to operations	(532)	(251)	(35)	(82)	(900)
Losses charged to allowance	(4)	—	(18)	—	(22)
Recoveries	514	5	22	—	541
Ending balance, September 30, 2017	$ 2,174	$ 5,685	$ 762	$ 295	$8,916
Allowance for credit losses:					
Beginning balance, July 1, 2016	$ 2,972	$ 5,660	$ 948	$ 292	$9,872
(Reversal) provision charged to operations	(963)	259	(23)	(273)	(1,000)
Losses charged to allowance	(494)	—	(36)	—	(530)
Recoveries	803	131	23	—	957
Ending balance, September 30, 2016	$ 2,318	$ 6,050	$ 912	$ 19	$9,299

The following table shows the summary of activities for the allowance for loan losses as of and for the nine months ended September 30, 2017 and 2016 by portfolio segment of loans (in thousands):

	Commercial	Real Estate	Consumer	Unallocated	Total
Allowance for credit losses:					
Beginning balance, January 1, 2017	$ 2,180	$ 6,200	$ 852	$ 94	$9,326
(Reversal) provision charged to operations	(776)	(554)	(21)	201	(1,150)
Losses charged to allowance	(48)	(22)	(162)	—	(232)
Recoveries	818	61	93	—	972
Ending balance, September 30, 2017	$ 2,174	$ 5,685	$ 762	$ 295	$8,916
Allowance for credit losses:					
Beginning balance, January 1, 2016	$ 3,562	$ 5,204	$ 734	$ 110	$9,610
(Reversal) provision charged to operations	(5,787)	(136)	164	(91)	(5,850)
Losses charged to allowance	(499)	—	(148)	—	(647)
Recoveries	5,042	982	162	—	6,186
Ending balance, September 30, 2016	$ 2,318	$ 6,050	$ 912	$ 19	$9,299

The following is a summary of the Allowance by impairment methodology and portfolio segment as of September 30, 2017 and December 31, 2016 (in thousands):

	Commercial	Real Estate	Consumer	Unallocated	Total
Allowance for credit losses:					
Ending balance, September 30, 2017	$ 2,174	$ 5,685	$ 762	$ 295	$8,916
Ending balance: individually evaluated for impairment	$ 1	$ 25	$ 30	$ —	$56
Ending balance: collectively evaluated for impairment	$ 2,173	$ 5,660	$ 732	$ 295	$8,860
Ending balance, December 31, 2016	$ 2,180	$ 6,200	$ 852	$ 94	$9,326
Ending balance: individually evaluated for impairment	$ 3	$ 241	$ 63	$ —	$307
Ending balance: collectively evaluated for impairment	$ 2,177	$ 5,959	$ 789	$ 94	$9,019

Table of Contents

	Commercial	Real Estate	Consumer	Total
Loans:				
Ending balance, September 30, 2017	$ 108,585	$ 579,715	$ 89,417	$ 777,717
Ending balance: individually evaluated for impairment	$ 394	$ 5,035	$ 199	$ 5,628
Ending balance: collectively evaluated for impairment	$ 108,191	$ 574,680	$ 89,218	$ 772,089
Loans:				
Ending balance, December 31, 2016	$ 114,161	$ 550,796	$ 90,404	$ 755,361
Ending balance: individually evaluated for impairment	$ 487	$ 4,238	$ 544	$ 5,269
Ending balance: collectively evaluated for impairment	$ 113,674	$ 546,558	$ 89,860	$ 750,092

The following table shows the loan portfolio by class allocated by management's internal risk ratings at September 30, 2017 (in thousands):

	Pass	Special Mention	Sub-Standard	Doubtful	Total
Commercial:					
Commercial and industrial	$ 74,450	$ 8,692	$ 7,369	$ —	$ 90,511
Agricultural land and production	9,036	1,986	7,052	—	18,074
Real Estate:					
Owner occupied	184,377	4,700	2,841	—	191,918
Real estate construction and other land loans	80,504	1,783	1,848	—	84,135
Commercial real estate	207,673	2,438	1,897	—	212,008
Agricultural real estate	43,136	1,290	27,656	—	72,082
Other real estate	19,572	—	—	—	19,572
Consumer:					
Equity loans and lines of credit	60,512	507	803	—	61,822
Consumer and installment	27,592	—	3	—	27,595
Total	$ 706,852	$ 21,396	$ 49,469	$ —	$ 777,717

The following table shows the loan portfolio by class allocated by management's internally assigned risk grade ratings at December 31, 2016 (in thousands):

	Pass	Special Mention	Sub-Standard	Doubtful	Total
Commercial:					
Commercial and industrial	$ 75,212	$ 907	$ 12,533	$ —	$ 88,652
Agricultural land and production	16,562	8,681	266	—	25,509
Real Estate:					
Owner occupied	184,987	2,865	3,813	—	191,665
Real estate construction and other land loans	62,538	5,259	1,403	—	69,200
Commercial real estate	179,966	1,548	2,711	—	184,225
Agricultural real estate	49,270	10,390	27,101	—	86,761
Other real estate	18,779	166	—	—	18,945
Consumer:					
Equity loans and lines of credit	62,782	95	1,617	—	64,494
Consumer and installment	25,890	—	20	—	25,910
Total	$ 675,986	$ 29,911	$ 49,464	$ —	$ 755,361

Table of Contents

The following table shows an aging analysis of the loan portfolio by class and the time past due at September 30, 2017 (in thousands):

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total Loans	Recorded Investment > 90 Days Accruing	Non-accrual
Commercial:								
Commercial and industrial	$ —	$ —	$ —	$ —	$ 90,511	$ 90,511	$ —	$ 372
Agricultural land and production	—	—	—	—	18,074	18,074	—	—
Real estate:	—			—	—	—		
Owner occupied	—	—	—	—	191,918	191,918	—	—
Real estate construction and other land loans	1,397	—	—	1,397	82,738	84,135	—	1,397
Commercial real estate	—	—	—	—	212,008	212,008	—	1,000
Agricultural real estate	—	—	—	—	72,082	72,082	—	—
Other real estate	—	—	—	—	19,572	19,572	—	—
Consumer:				—	—	—		
Equity loans and lines of credit	19	—	—	19	61,803	61,822	—	199
Consumer and installment	60	2	—	62	27,533	27,595	—	—
Total	$ 1,476	$ 2	$ —	$ 1,478	$ 776,239	$ 777,717	$ —	$ 2,968

The following table shows an aging analysis of the loan portfolio by class and the time past due at December 31, 2016 (in thousands):

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total Loans	Recorded Investment > 90 Days Accruing	Non-accrual
Commercial:								
Commercial and industrial	$ —	$ —	$ —	$ —	$ 88,652	$ 88,652	$ —	$ 447
Agricultural land and production	—	—	—	—	25,509	25,509	—	—
Real estate:	—							
Owner occupied	87	—	—	87	191,578	191,665	—	107
Real estate construction and other land loans	—	—	—	—	69,200	69,200	—	—
Commercial real estate	565	—	—	565	183,660	184,225	—	1,082
Agricultural real estate	—	—	—	—	86,761	86,761	—	—
Other real estate	—	—	—	—	18,945	18,945	—	—
Consumer:								
Equity loans and lines of credit	62	48	—	110	64,384	64,494	—	526
Consumer and installment	38	—	—	38	25,872	25,910	—	18
Total	$ 752	$ 48	$ —	$ 800	$ 754,561	$ 755,361		