

CENTRAL VALLEY COMMUNITY BANCORP
Form 10-Q
August 07, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q
(Mark One)

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

FOR THE QUARTERLY PERIOD ENDED June 30, 2014

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 (I.R.S. Employer Identification No.)
organization)

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 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 (§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 No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

As of August 1, 2014 there were 10,927,925 shares of the registrant's common stock outstanding.

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CENTRAL VALLEY COMMUNITY BANCORP AND SUBSIDIARY

2014 QUARTERLY REPORT ON FORM 10-Q

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PART 1: FINANCIAL INFORMATION

ITEM 1: FINANCIAL STATEMENTS

CENTRAL VALLEY COMMUNITY BANCORP AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS

(In thousands, except share amounts)	June 30, 2014 (Unaudited)	December 31, 2013
ASSETS		
Cash and due from banks	\$30,504	\$25,878
Interest-earning deposits in other banks	36,096	85,956
Federal funds sold	295	218
Total cash and cash equivalents	66,895	112,052
Available-for-sale investment securities (Amortized cost of \$434,162 at June 30, 2014 and \$447,108 at December 31, 2013)	441,223	443,224
Held-to-maturity investment securities (Fair value of \$33,666 at June 30, 2014)	31,711	—
Loans, less allowance for credit losses of \$7,307 at June 30, 2014 and \$9,208 at December 31, 2013	537,848	503,149
Bank premises and equipment, net	10,540	10,541
Other real estate owned	—	190
Bank owned life insurance	20,647	19,443
Federal Home Loan Bank stock	4,791	4,499
Goodwill	29,917	29,917
Core deposit intangibles	1,512	1,680
Accrued interest receivable and other assets	15,604	20,940
Total assets	\$1,160,688	\$1,145,635
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Non-interest bearing	\$351,341	\$356,392
Interest bearing	657,871	647,751
Total deposits	1,009,212	1,004,143
Junior subordinated deferrable interest debentures	5,155	5,155
Accrued interest payable and other liabilities	15,390	16,294
Total liabilities	1,029,757	1,025,592
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: 10,927,925 at June 30, 2014 and 10,914,680 at December 31, 2013	54,066	53,981
Retained earnings	72,565	68,348
Accumulated other comprehensive income (loss), net of tax	4,300	(2,286)
Total shareholders' equity	130,931	120,043
Total liabilities and shareholders' equity	\$1,160,688	\$1,145,635

See notes to unaudited consolidated financial statements.

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CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

(In thousands, except share and per share amounts)	For the Three Months		For the Six Months	
	Ended June 30, 2014	2013	Ended June 30, 2014	2013
INTEREST INCOME:				
Interest and fees on loans	\$7,278	\$5,435	\$14,896	\$10,846
Interest on deposits in other banks	44	29	97	59
Interest and dividends on investment securities:				
Taxable	1,439	352	2,786	753
Exempt from Federal income taxes	1,434	1,398	2,836	2,736
Total interest income	10,195	7,214	20,615	14,394
INTEREST EXPENSE:				
Interest on deposits	267	312	564	605
Interest on junior subordinated deferrable interest debentures	23	24	47	49
Other	—	—	—	17
Total interest expense	290	336	611	671
Net interest income before provision for credit losses	9,905	6,878	20,004	13,723
PROVISION FOR CREDIT LOSSES	(400	) —	(400) —
Net interest income after provision for credit losses	10,305	6,878	20,404	13,723
NON-INTEREST INCOME:				
Service charges	822	673	1,630	1,371
Appreciation in cash surrender value of bank owned life insurance	157	97	303	193
Interchange fees	342	213	629	409
Net (loss) gain on disposal of other real estate owned	(1	) —	63	—
Net realized gains on sales of investment securities	64	320	333	1,133
Federal Home Loan Bank dividends	75	32	151	54
Loan placement fees	131	214	189	379
Other income	454	278	723	514
Total non-interest income	2,044	1,827	4,021	4,053
NON-INTEREST EXPENSES:				
Salaries and employee benefits	4,845	3,974	9,756	7,868
Occupancy and equipment	1,320	901	2,450	1,802
Data processing	463	289	913	592
Regulatory assessments	193	154	391	297
ATM/Debit card expenses	160	109	310	218
License and maintenance contracts	128	100	258	199
Advertising	153	80	308	222
Audit and accounting fees	175	136	307	271
Internet banking expense	96	76	225	148
Acquisition and integration	—	380	—	513
Amortization of core deposit intangibles	84	50	168	100
Other	1,117	974	2,384	1,926
Total non-interest expenses	8,734	7,223	17,470	14,156
Income before provision for income taxes	3,615	1,482	6,955	3,620

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Provision for income taxes	922	195	1,646	550
Net income	\$2,693	\$1,287	\$5,309	\$3,070
Preferred stock dividends and accretion	—	88	—	175
Net income available to common shareholders	\$2,693	\$1,199	\$5,309	\$2,895
Earnings per common share:				
Basic earnings per share	\$0.25	\$0.13	\$0.49	\$0.30
Weighted average common shares used in basic computation	10,918,065	9,587,376	10,917,010	9,573,257
Diluted earnings per share	\$0.24	\$0.12	\$0.48	\$0.30
Weighted average common shares used in diluted computation	10,999,663	9,644,938	10,996,572	9,629,771
Cash dividend per common share	\$0.05	\$0.05	\$0.10	\$0.10

See notes to unaudited consolidated financial statements.

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CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(Unaudited)

(In thousands)	For the Three Months		For the Six Months	
	Ended June 30,		Ended June 30,	
	2014	2013	2014	2013
Net income	\$2,693	\$1,287	\$5,309	\$3,070
Other Comprehensive Income (Loss):				
Unrealized gains (losses) on securities:				
Unrealized holdings gains (losses) arising and transferred during the period	4,424	(11,921)	11,441	(13,992)
Less: reclassification for net gains included in net income	64	320	333	1,133
Amortization of net unrealized gains transferred during the period	—	—	(18)	—
Other comprehensive income (loss), before tax	4,360	(12,241)	11,090	(15,125)
Tax (expense) benefit related to items of other comprehensive income	(1,794)	5,037	(4,504)	6,224
Total other comprehensive income (loss)	2,566	(7,204)	6,586	(8,901)
Comprehensive income (loss)	\$5,259	\$(5,917)	\$11,895	\$(5,831)

See notes to unaudited consolidated financial statements.

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CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

(In thousands)	For the Six Months Ended June 30,	
	2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$5,309	\$3,070
Adjustments to reconcile net income to net cash provided by operating activities:		
Net decrease in deferred loan fees	(146)	(162)
Depreciation	675	501
Accretion	(451)	(385)
Amortization	3,807	4,675
Stock-based compensation	54	50
Tax benefit from exercise of stock options	(6)	(16)
Provision for credit losses	(400)	—
Net realized gains on sales of available-for-sale investment securities	(333)	(1,133)
Net loss (gain) on disposal of premises and equipment	66	(1)
Net gain on sale of other real estate owned	(63)	—
Increase in bank owned life insurance, net of expenses	(303)	(193)
Net decrease (increase) in accrued interest receivable and other assets	22	(205)
Net decrease in prepaid FDIC assessments	—	1,542
Net increase in accrued interest payable and other liabilities	(903)	(124)
Provision for (benefit from) deferred income taxes	815	(548)
Net cash provided by operating activities	8,143	7,071
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of available-for-sale investment securities	(96,574)	(75,306)
Proceeds from sales or calls of available-for-sale investment securities	52,241	35,853
Proceeds from maturity and principal repayments of available-for-sale investment securities	22,856	44,822
Net increase in loans	(34,388)	(9,997)
Proceeds from sale of other real estate owned	488	—
Purchases of premises and equipment	(739)	(620)
Purchases of bank owned life insurance	(900)	—
FHLB stock (purchased) redeemed	(292)	48
Proceeds from sale of premises and equipment	—	1
Net cash used in investing activities	(57,308)	(5,199)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase (decrease) in demand, interest bearing and savings deposits	10,157	(18,308)
Net (decrease) increase in time deposits	(5,088)	5,273
Repayments of short-term borrowings to Federal Home Loan Bank	—	(4,000)
Proceeds from exercise of stock options	25	773
Excess tax benefit from exercise of stock options	6	16
Cash dividend payments on common stock	(1,092)	(956)
Cash dividend payments on preferred stock	—	(175)
Net cash provided by (used in) financing activities	4,008	(17,377)
Decrease in cash and cash equivalents	(45,157)	(15,505)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	112,052	52,956

CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$66,895	\$37,451
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(In thousands)	For the Six Months Ended June 30,	
	2014	2013
SUPPLEMENTAL DISCLOSURE OF CASH FLOWS INFORMATION:		
Cash paid during the period for:		
Interest	\$627	\$750
Income taxes	\$620	\$940
Non-cash investing and financing activities:		
Foreclosure of loan collateral and recognition of other real estate owned	\$235	\$—
Transfer of securities from available-for-sale to held-to-maturity	\$31,346	\$—
Unrealized gain on transfer of securities from available-for-sale to held-to-maturity	\$163	\$—
Accrued preferred stock dividends	\$—	\$87
Purchases of Available-for-sale investment securities, not yet settled	\$—	\$4,425

See notes to unaudited consolidated financial statements.

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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. As discussed in Note 2, on July 1, 2013, the Company completed an acquisition under which Visalia Community Bank merged with and into Central Valley Community Bancorp's subsidiary, Central Valley Community Bank. 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 consolidated financial statements should be read in conjunction with the audited financial statements and notes thereto included in the Company's 2013 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 June 30, 2014, and the results of its operations and its cash flows for the three and six month interim periods ended June 30, 2014 and 2013 have been included. Certain reclassifications have been made to prior year amounts to conform to the 2014 presentation. Reclassifications had no effect on prior period net income or shareholders' equity. The results of operations for interim periods are not necessarily indicative of results for the full year.

The preparation of these 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 period. 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.

Note 2. Acquisition of Visalia Community Bank

Effective July 1, 2013, the Company acquired Visalia Community Bank, headquartered in Visalia, California, wherein Visalia Community Bank, with three full-service offices in Visalia and one in Exeter, merged with and into Central Valley Community Bancorp's subsidiary, Central Valley Community Bank. Visalia Community Bank's assets (unaudited) as of July 1, 2013 totaled approximately \$197 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 1.263 million shares of its common stock and cash totaling approximately \$11.05 million to the former shareholders of Visalia Community Bank. Each Visalia Community Bank common shareholder of record at the effective time of the merger became entitled to receive 2.971 shares of common stock of the Company for each of their former shares of Visalia Community Bank common stock.

The Company recorded \$6.2 million of goodwill and \$1.4 million of other intangible assets at the date of acquisition. 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 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.

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 as of January 1, 2013. The pro forma results of operations for the six months ended June 30, 2013 include the historical accounts of the Company and Visalia Community 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

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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 2013. No assumptions have been applied to the pro forma results of operations regarding possible revenue enhancements, expense efficiencies or asset dispositions.

Pro Forma Results of Operations	For the Six Months Ended June 30, 2013
(In thousands, except per share amounts)	
Net interest income	\$ 17,045
Provision for credit losses	298
Non-interest income	4,797
Non-interest expense	19,592
Income before provision for income taxes	1,952
Benefit from income taxes	(14)
Net income	\$ 1,966
Basic earnings per share	\$0.17
Diluted earnings per share	\$0.16

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):

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(In thousands)	June 30, 2014				
	Carrying Amount	Fair Value Level 1	Level 2	Level 3	Total
Financial assets:					
Cash and due from banks	\$30,504	\$30,504	\$—	\$—	\$30,504
Interest-earning deposits in other banks	36,096	36,096	—	—	36,096
Federal funds sold	295	295	—	—	295
Available-for-sale investment securities	441,223	7,633	433,590	—	441,223
Held-to-maturity investment securities	31,711	—	33,666	—	33,666
Loans, net	537,848	—	—	540,215	540,215
Federal Home Loan Bank stock	4,791	N/A	N/A	N/A	N/A
Accrued interest receivable	5,346	20	3,121	2,205	5,346
Financial liabilities:					
Deposits	1,009,212	844,682	164,186	—	1,008,868
Junior subordinated deferrable interest debentures	5,155	—	—	2,900	2,900
Accrued interest payable	113	—	89	24	113
(In thousands)	December 31, 2013				
	Carrying Amount	Fair Value Level 1	Level 2	Level 3	Total
Financial assets:					
Cash and due from banks	\$25,878	\$25,878	\$—	\$—	\$25,878
Interest-earning deposits in other banks	85,956	85,956	—	—	85,956
Federal funds sold	218	218	—	—	218
Available-for-sale investment securities	443,224	7,514	435,710	—	443,224
Loans, net	503,149	—	—	507,361	507,361
Federal Home Loan Bank stock	4,499	N/A	N/A	N/A	N/A
Accrued interest receivable	5,026	21	2,976	2,029	5,026
Financial liabilities:					
Deposits	1,004,143	834,864	169,065	—	1,003,929
Junior subordinated deferrable interest debentures	5,155	—	—	2,750	2,750
Accrued interest payable	129	—	105	24	129

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.

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(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 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.

(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 material.

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 June 30, 2014:

Recurring Basis

The Company is required or permitted to record the following assets at fair value on a recurring basis as of June 30, 2014 (in thousands).

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Description	Fair Value	Level 1	Level 2	Level 3
Available-for-sale securities				
Debt Securities:				
U.S. Government agencies	\$17,336	\$—	\$17,336	\$—
Obligations of states and political subdivisions	137,117	—	137,117	—
U.S. Government sponsored entities and agencies collateralized by residential mortgage obligations	274,102	—	274,102	—
Private label residential mortgage backed securities	5,035	—	5,035	—
Other equity securities	7,633	7,633	—	—
Total assets measured at fair value on a recurring basis	\$441,223	\$7,633	\$433,590	\$—

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 six months ended June 30, 2014, no transfers between levels occurred.

There were no Level 3 assets measured at fair value on a recurring basis at or during the six month period ended June 30, 2014. Also there were no liabilities measured at fair value on a recurring basis at June 30, 2014.

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 June 30, 2014 (in thousands).

Description	Fair Value	Level 1	Level 2	Level 3
Assets:				
Impaired loans:				
Consumer:				
Equity loans and lines of credit	\$145	\$—	\$—	\$145
Total assets measured at fair value on a non-recurring basis	\$145	\$—	\$—	\$145

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 date, 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 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 six month period ended June 30, 2014.

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 \$174,000 with a valuation allowance of \$29,000 at June 30, 2014, resulting in fair value of \$145,000. The valuation allowance represents specific allocations for the allowance for credit losses for impaired loans.

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During the three and six months ended June 30, 2014, there was no provision for credit losses recorded related to loans carried at fair value. During the three and six months ended June 30, 2014, there was \$287,000 and \$308,000 of charge-offs related to loans carried at fair value, respectively.

During the three and six months ended June 30, 2013, there was no provision for credit losses recorded related to loans carried at fair value. During the three and six months ended June 30, 2013, there were no of charge-offs related to loans carried at fair value.

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, 2013:

Recurring Basis

The Company is required or permitted to record the following assets at fair value on a recurring basis as of December 31, 2013 (in thousands).

Description	Fair Value	Level 1	Level 2	Level 3
Available-for-sale securities				
Debt Securities:				
U.S. Government agencies	\$ 18,203	\$—	\$ 18,203	\$—
Obligations of states and political subdivisions	158,407	—	158,407	—
U.S. Government sponsored entities and agencies collateralized by residential mortgage obligations	253,709	—	253,709	—
Private label residential mortgage backed securities	5,391	—	5,391	—
Other equity securities	7,514	7,514	—	—
Total assets measured at fair value on a recurring basis	\$443,224	\$7,514	\$435,710	\$—

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, 2013, 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, 2013. Also there were no liabilities measured at fair value on a recurring basis at December 31, 2013.

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, 2013 (in thousands).

Description	Fair Value	Level 1	Level 2	Level 3
Impaired loans:				
Consumer:				
Equity loans and lines of credit	\$ 133	\$—	\$—	\$ 133
Total assets measured at fair value on a non-recurring basis	\$ 133	\$—	\$—	\$ 133

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

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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 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 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 year ended December 31, 2013

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 \$194,000 with a valuation allowance of \$61,000 at December 31, 2013, resulting in fair value of \$133,000. The valuation allowance represents specific allocations for the allowance for credit losses for impaired loans.

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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 June 30, 2014, \$107,847,000 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 \$7,061,000 at June 30, 2014 compared to an unrealized loss of \$3,884,000 at December 31, 2013.

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

	June 30, 2014			
Available-for-Sale Securities	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Government agencies	\$17,286	\$100	\$(50)	) \$17,336
Obligations of states and political subdivisions	133,521	4,561	(965)	) 137,117
U.S. Government sponsored entities and agencies collateralized by residential mortgage obligations	272,082	2,823	(803)	) 274,102
Private label residential mortgage backed securities	3,677	1,358	—	5,035
Other equity securities	7,596	37	—	7,633
Total available-for-sale	\$434,162	\$8,879	\$(1,818)	) \$441,223
	June 30, 2014			
Held-to-Maturity Securities	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
Obligations of states and political subdivisions	\$31,711	\$1,983	\$(28)	) \$33,666
	December 31, 2013			
Available-for-Sale Securities	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Government agencies	\$18,172	\$115	\$(84)	) \$18,203
Obligations of states and political subdivisions	162,018	2,906	(6,517)	) 158,407
U.S. Government sponsored entities and agencies collateralized by residential mortgage obligations	254,978	1,075	(2,344)	) 253,709
Private label residential mortgage backed securities	4,344	1,047	—	5,391
Other equity securities	7,596	2	(84)	) 7,514
Total available-for-sale	\$447,108	\$5,145	\$(9,029)	) \$443,224

Proceeds and gross realized gains (losses) from the sales or calls of investment securities for the periods ended June 30, 2014 and 2013 are shown below (in thousands):

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2014	2013	2014	2013
Available-for-Sale Securities				
Proceeds from sales or calls	\$25,525	\$13,696	\$52,241	\$35,853
Gross realized gains from sales or calls	190	395	1,152	1,401

Gross realized losses from sales or calls (126) (75) (819) (268)

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Losses recognized in 2014 and 2013 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. The securities which were sold were primarily purchased several years ago to serve a purpose in the rate environment in which the securities were purchased. The Company is addressing risks in the security portfolio by selling these securities and using proceeds to purchase securities that fit with the Company's current risk profile. The provision for income taxes includes \$137,000 and \$466,000 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 six months ended June 30, 2014 and 2013, respectively. The provision for income taxes includes \$26,000 and \$132,000 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 June 30, 2014 and 2013, 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):

Available-for-Sale Securities	June 30, 2014					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Debt securities:						
U.S. Government agencies	\$11,854	\$(44)	\$916	\$(6)	\$12,770	\$(50)
Obligations of states and political subdivisions	4,982	(37)	40,715	(928)	45,697	(965)
U.S. Government sponsored entities and agencies collateralized by residential mortgage obligations	46,082	(388)	34,120	(415)	80,202	(803)
Total available-for-sale	\$62,918	\$(469)	\$75,751	\$(1,349)	\$138,669	\$(1,818)
Held-to-Maturity Securities	June 30, 2014					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Debt securities:						
Obligations of states and political subdivisions	\$1,055	\$(28)	\$—	\$—	\$1,055	\$(28)
Available-for-Sale Securities	December 31, 2013					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Debt securities:						
U.S. Government agencies	\$4,132	\$(75)	\$968	\$(9)	\$5,100	\$(84)
Obligations of states and political subdivisions	89,556	(5,007)	15,015	(1,510)	104,571	(6,517)
U.S. Government sponsored entities and agencies collateralized by residential mortgage obligations	148,853	(2,070)	19,199	(274)	168,052	(2,344)
Other equity securities	7,416	(84)	—	—	7,416	(84)
Total available-for-sale	\$249,957	\$(7,236)	\$35,182	\$(1,793)	\$285,139	\$(9,029)

We periodically evaluate 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 June 30, 2014, 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). Management evaluated all available-for-sale investment securities with an unrealized loss at June 30, 2014 and identified those that had an unrealized loss for at least a consecutive 12 month period, which had an unrealized loss at June 30, 2014 greater than 10% of the recorded book value on

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that date, or which had an unrealized loss of more than \$10,000. Management 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 municipal debt securities with an investment grade rating by the rating agencies, management also evaluated the financial condition of the municipality and any applicable municipal bond insurance provider and concluded that no credit related impairment existed.

U.S. Government Agencies

At June 30, 2014, the Company held seven U.S. Government agency securities, of which four were in a loss position for less than 12 months and one was in a loss position and 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 maturity, the Company does not consider those investments to be other-than-temporarily impaired at June 30, 2014.

Obligations of States and Political Subdivisions

At June 30, 2014, the Company held 142 obligations of states and political subdivision securities of which five were in a loss position for less than 12 months and 25 were in a loss position and 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 June 30, 2014.

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

At June 30, 2014, the Company held 211 U.S. Government sponsored entity and agency securities collateralized by residential mortgage obligations of which 22 were in a loss position for less than 12 months and 19 have been in a loss 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 June 30, 2014.

Private Label Residential Mortgage Backed Securities

At June 30, 2014, the Company had a total of 21 PLRMBS with a remaining principal balance of \$3,677,000 and a net unrealized gain of approximately \$1,358,000. None of these securities were recorded with an unrealized loss at June 30, 2014. Eleven of these PLRMBS with a remaining principal balance of \$3,121,000 had credit ratings below investment grade. The Company continues to perform extensive analyses on these securities.

Other Equity Securities

At June 30, 2014, the Company had a total of two mutual fund equity investments. Neither of these investments were recorded with an unrealized loss at June 30, 2014.

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The following tables provide a roll forward for the three and six month periods ended June 30, 2014 and 2013 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.

(In thousands)	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2014	2013	2014	2013
Beginning balance	\$ 800	\$ 800	\$ 800	\$ 783
Amounts related to credit loss for which an OTTI charge was not previously recognized	—	—	—	17
Increases to the amount related to credit loss for which OTTI was previously recognized	—	—	—	—
Realized losses for securities sold	—	—	—	—
Ending balance	\$ 800	\$ 800	\$ 800	\$ 800

The amortized cost and estimated fair value of available-for-sale and held-to-maturity investment securities at June 30, 2014 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.

Available-for-Sale Securities	June 30, 2014	
	Amortized Cost	Estimated Fair Value
Within one year	\$—	\$—
After one year through five years	2,673	2,956
After five years through ten years	15,317	15,936
After ten years	115,531	118,225
	133,521	137,117
Investment securities not due at a single maturity date:		
U.S. Government agencies	17,286	17,336
U.S. Government sponsored entities and agencies collateralized by residential mortgage obligations	272,082	274,102
Private label residential mortgage backed securities	3,677	5,035
Other equity securities	7,596	7,633
Total available-for-sale	\$434,162	\$441,223

Held-to-Maturity Securities	June 30, 2014	
	Amortized Cost	Estimated Fair Value
After ten years	\$31,711	\$33,666

During the quarter ended March 31, 2014, to better manage our interest rate risk, we 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 unrealized gain of approximately \$163,000. This transfer was completed after careful consideration of our intent and ability to hold these securities to maturity. There were no transfers or reclassifications of securities in or out of held-to-maturity during the quarter ended June 30, 2014.

Note 5. Loans and Allowance for Credit Losses

Outstanding loans are summarized as follows:

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Loan Type (Dollars in thousands)	June 30, 2014	% of Total Loans	December 31, 2013	% of Total Loans	
Commercial:					
Commercial and industrial	\$89,145	16.4	% \$87,082	17.0	%
Agricultural land and production	42,021	7.6	% 31,649	6.1	%
Total commercial	131,166	24.0	% 118,731	23.1	%
Real estate:					
Owner occupied	157,938	29.0	% 156,781	30.6	%
Real estate construction and other land loans	38,969	7.1	% 42,329	8.3	%
Commercial real estate	96,805	17.8	% 86,117	16.8	%
Agricultural real estate	58,106	10.7	% 44,164	8.6	%
Other real estate	5,054	0.9	% 4,548	0.9	%
Total real estate	356,872	65.5	% 333,939	65.2	%
Consumer:					
Equity loans and lines of credit	47,735	8.8	% 48,594	9.5	%
Consumer and installment	9,394	1.7	% 11,252	2.2	%
Total consumer	57,129	10.5	% 59,846	11.7	%
Deferred loan fees, net	(12)		(159)		
Total gross loans	545,155	100.0	% 512,357	100.0	%
Allowance for credit losses	(7,307)		(9,208)		
Total loans	\$537,848		\$503,149		

The table above includes loans acquired at fair value on July 1, 2013 in the VCB acquisition with outstanding balances of \$82,262,000 and \$99,948,000 as of June 30, 2014 and December 31, 2013, respectively.

At June 30, 2014 and December 31, 2013, loans originated under Small Business Administration (SBA) programs totaling \$7,667,000 and \$7,345,000, respectively, were included in the real estate and commercial categories.

Purchased Credit Impaired Loans

The Company has loans that were acquired in an acquisition, 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.

These purchased credit impaired loans are recorded at the amount paid, such that there is no carryover of the seller's allowance for loan losses. After acquisition, losses are recognized by an increase in the 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.

The carrying amount of those loans is included in the balance sheet amounts of loans receivable at June 30, 2014 and December 31, 2013. The amounts of loans at June 30, 2014 and December 31, 2013 are as follows (in thousands):

	June 30, 2014	December 31, 2013
Real estate	\$—	\$ 2,465

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Outstanding balance	\$—	\$ 2,465
Carrying amount, net of allowance of \$0	\$—	\$ 2,465

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Accretible yield, or income expected to be collected for the three and six months ended June 30, 2014 and 2013 is as follows (in thousands):

	For the Three Months		For the Six Months	
	Ended June 30,		Ended June 30,	
	2014	2013	2014	2013
Balance at beginning of period	\$8	\$—	\$94	\$—
Additions	—	—	—	—
Accretion	(129	) —	(907) —
Reclassification from (to) non-accretible difference	121	—	813	—
Disposals	—	—	—	—
Balance at end of period	\$—	\$—	\$—	\$—

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

	June 30, 2014	December 31, 2013
Contractually required payments receivable at acquisition:		
Real estate	\$—	\$6,912
Total	\$—	\$6,912
Cash flows expected to be collected at acquisition	\$—	\$2,681
Fair value of in acquired loans at acquisition	\$—	\$2,576

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 (in thousands):

	June 30, 2014	December 31, 2013
Loans acquired during the period	\$—	\$1,324
Loans at the end of the period	\$—	\$1,324

The allowance for credit losses (the “allowance”) is an estimate of probable incurred credit losses inherent in the Company’s loan portfolio that have been incurred as of the balance-sheet date. 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 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.

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The following table shows the summary of activities for the allowance for credit losses as of and for the three months ended June 30, 2014 and 2013 by portfolio segment (in thousands):

	Commercial	Real Estate	Consumer	Unallocated	Total
Allowance for credit losses:					
Beginning balance, April 1, 2014	\$ 2,012	\$ 4,672	\$ 1,391	\$ 246	\$ 8,321
Provision charged to operations	78	(340)	(187)	49	(400)
Losses charged to allowance	(265)	(183)	(325)	—	(773)
Recoveries	49	8	102	—	159
Ending balance, June 30, 2014	\$ 1,874	\$ 4,157	\$ 981	\$ 295	\$ 7,307
Allowance for credit losses:					
Beginning balance, April 1, 2013	\$ 2,261	\$ 5,536	\$ 1,315	\$ 377	\$ 9,489
Provision charged to operations	433	(479)	(77)	123	—
Losses charged to allowance	(4)	—	(18)	—	(22)
Recoveries	102	—	32	—	134
Ending balance, June 30, 2013	\$ 2,792	\$ 5,057	\$ 1,252	\$ 500	\$ 9,601

The following table shows the summary of activities for the allowance for credit losses as of and for the six months ended June 30, 2014 and 2013 by portfolio segment of loans (in thousands):

	Commercial	Real Estate	Consumer	Unallocated	Total
Allowance for credit losses:					
Beginning balance, January 1, 2014	\$ 2,444	\$ 5,174	\$ 1,168	\$ 422	\$ 9,208
Provision charged to operations	526	(850)	51	(127)	(400)
Losses charged to allowance	(1,194)	(183)	(410)	—	(1,787)
Recoveries	98	16	172	—	286
Ending balance, June 30, 2014	\$ 1,874	\$ 4,157	\$ 981	\$ 295	\$ 7,307
Allowance for credit losses:					
Beginning balance, January 1, 2013	\$ 2,676	\$ 5,877	\$ 1,541	\$ 39	\$ 10,133
Provision charged to operations	674	(820)	(315)	461	—
Losses charged to allowance	(702)	—	(35)	—	(737)
Recoveries	144	—	61	—	205
Ending balance, June 30, 2013	\$ 2,792	\$ 5,057	\$ 1,252	\$ 500	\$ 9,601

The following is a summary of the allowance for credit losses by impairment methodology and portfolio segment as of June 30, 2014 and December 31, 2013 (in thousands).

	Commercial	Real Estate	Consumer	Unallocated	Total
Allowance for credit losses:					
Ending balance, June 30, 2014	\$ 1,874	\$ 4,157	981	\$ 295	\$ 7,307
Ending balance: individually evaluated for impairment	\$ —	\$ 324	42	\$ —	\$ 366
Ending balance: collectively evaluated for impairment	\$ 1,874	\$ 3,833	939	\$ 295	\$ 6,941
Ending balance, December 31, 2013					
Ending balance, December 31, 2013	\$ 2,444	\$ 5,174	\$ 1,168	\$ 422	\$ 9,208
Ending balance: individually evaluated for impairment	\$ 469	\$ 465	\$ 73	\$ —	\$ 1,007
Ending balance: collectively evaluated for impairment	\$ 1,975	\$ 4,709	\$ 1,095	\$ 422	\$ 8,201

The table above excludes ending balance of loans acquired with deteriorated quality of \$2,465,000 with no allowance at December 31, 2013. There were no such loans at June 30, 2014.

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The following table shows the ending balances of loans as of June 30, 2014 and December 31, 2013 by portfolio segment and by impairment methodology (in thousands):

	Commercial	Real Estate	Consumer	Total
Loans:				
Ending balance, June 30, 2014	\$ 131,166	\$ 356,872	\$ 57,129	\$ 545,167
Ending balance: individually evaluated for impairment	\$ 38	\$ 8,072	\$ 2,037	\$ 10,147
Ending balance: collectively evaluated for impairment	\$ 131,128	\$ 348,800	\$ 55,092	\$ 535,020
Loans:				
Ending balance, December 31, 2013	\$ 118,731	\$ 333,939	\$ 59,846	\$ 512,516
Ending balance: individually evaluated for impairment	\$ 1,527	\$ 9,540	\$ 2,290	\$ 13,357
Ending balance: collectively evaluated for impairment	\$ 117,204	\$ 324,399	\$ 57,556	\$ 499,159

The following table shows the loan portfolio by class allocated by management's internal risk ratings at June 30, 2014 (in thousands):

	Pass	Special Mention	Sub-Standard	Doubtful	Total
Commercial:					
Commercial and industrial	\$83,572	\$2,649	\$ 2,924	\$—	\$89,145
Agricultural land and production	42,021	—	—	—	42,021
Real Estate:					
Owner occupied	149,835	4,058	4,045	—	157,938
Real estate construction and other land loans	30,266	1,944	6,759	—	38,969
Commercial real estate	85,465	3,880	7,460	—	96,805
Agricultural real estate	55,598	2,508	—	—	58,106
Other real estate	5,054	—	—	—	5,054
Consumer:					
Equity loans and lines of credit	40,985	1,970	4,780	—	47,735
Consumer and installment	9,368	—	26	—	9,394
Total	\$502,164	\$17,009	\$ 25,994	\$—	\$545,167

The following table shows the loan portfolio by class allocated by management's internally assigned risk grade ratings at December 31, 2013 (in thousands):

	Pass	Special Mention	Sub-Standard	Doubtful	Total
Commercial:					
Commercial and industrial	\$81,732	\$2,244	\$ 3,106	\$—	\$87,082
Agricultural land and production	31,649	—	—	—	31,649
Real Estate:					
Owner occupied	144,082	5,229	7,470	—	156,781
Real estate construction and other land loans	31,776	3,959	6,594	—	42,329
Commercial real estate	77,589	3,718	4,810	—	86,117
Agricultural real estate	42,151	2,013	—	—	44,164
Other real estate	4,548	—	—	—	4,548
Consumer:					
Equity loans and lines of credit	41,999	2,400	4,195	—	48,594
Consumer and installment	10,946	46	260	—	11,252
Total	\$466,472	\$19,609	\$ 26,435	\$—	\$512,516

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The following table shows an aging analysis of the loan portfolio by class and the time past due at June 30, 2014 (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	\$ 69	\$—	\$—	\$ 69	\$89,076	\$89,145	\$—	\$ 38
Agricultural land and production	—	—	—	—	42,021	42,021	—	—
Real estate:								
Owner occupied	—	256	58	314	157,624	157,938	—	1,068
Real estate construction and other land loans	—	—	—	—	38,969	38,969	—	1,358
Commercial real estate	—	—	—	—	96,805	96,805	—	134
Agricultural real estate	—	—	—	—	58,106	58,106	—	—
Other real estate	—	—	—	—	5,054	5,054	—	—
Consumer:								
Equity loans and lines of credit	423	—	227	650	47,085	47,735	—	2,012
Consumer and installment	99	—	—	99	9,295	9,394	—	22
Total	\$ 591	\$256	\$285	\$ 1,132	\$544,035	\$545,167	\$—	\$ 4,632

The following table shows an aging analysis of the loan portfolio by class and the time past due at December 31, 2013 (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	\$ 274	\$236	\$—	\$ 510	\$86,572	\$87,082	\$—	\$1,527
Agricultural land and production	—	—	—	—	31,649	31,649	—	—
Real estate:								
Owner occupied	1,272	134	418	1,824	154,957	156,781	—	2,161
Real estate construction and other land loans	—	—	—	—	42,329	42,329	—	1,450
Commercial real estate	—	—	—	—	86,117	86,117	—	158
Agricultural real estate	—	—	—	—	44,164	44,164	—	—
Other real estate	—	—	—	—	4,548	4,548	—	—
Consumer:								
Equity loans and lines of credit	10	147	252	409	48,185	48,594	—	2,286
Consumer and installment	86	—	—	86	11,166	11,252	—	4

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Total	\$ 1,642	\$ 517	\$ 670	\$ 2,829	\$ 509,687	\$ 512,516	\$—	\$ 7,586
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The following table shows information related to impaired loans by class at June 30, 2014 (in thousands):

	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:			
Commercial:			
Commercial and industrial	\$38	\$871	\$—
Real estate:			
Owner occupied	2,427	2,691	—
Real estate construction and other land loans	1,358	1,307	—
Commercial real estate	469	490	—
Total real estate	4,254	4,488	—
Consumer:			
Equity loans and lines of credit	1,741	2,411	—
Consumer and installment	25	28	—
Total consumer	1,766	2,439	—
Total with no related allowance recorded	6,058	7,798	—
With an allowance recorded:			
Real estate:			
Real estate construction and other land loans	3,818	3,817	324
Consumer:			
Equity loans and lines of credit	271	277	42
Total with an allowance recorded	4,089	4,094	366
Total	\$10,147	\$11,892	\$366

The recorded investment in loans excludes accrued interest receivable and net loan origination fees, due to immateriality.

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The following table shows information related to impaired loans by class at December 31, 2013 (in thousands):

	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:			
Commercial:			
Commercial and industrial	\$350	\$385	\$—
Real estate:			
Owner occupied	3,160	4,159	—
Real estate construction and other land loans	1,449	2,136	—
Commercial real estate	502	891	—
Total real estate	5,111	7,186	—
Consumer:			
Equity loans and lines of credit	2,029	2,826	—
Consumer and installment	4	5	—
Total consumer	2,033	2,831	—
Total with no related allowance recorded	7,494	10,402	—
With an allowance recorded:			
Commercial:			
Commercial and industrial	1,177	1,222	469
Real estate:			
Owner occupied	385	425	3
Real estate construction and other land loans	4,044	4,044	462
Total real estate	4,429	4,469	465
Consumer:			
Equity loans and lines of credit	257	264	73
Total with an allowance recorded	5,863	5,955	1,007
Total	\$13,357	\$16,357	\$1,007

The recorded investment in loans excludes accrued interest receivable and net loan origination fees, due to immateriality.

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The following presents by class, information related to the average recorded investment and interest income recognized on impaired loans for the three months ended June 30, 2014 and 2013.

	Three Months Ended June 30, 2014		Three Months Ended June 30, 2013	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:				
Commercial:				
Commercial and industrial	\$155	\$ —	\$ —	\$ —
Real estate:				
Owner occupied	2,532	20	204	—
Real estate construction and other land loans	1,245	—	5,432	—
Commercial real estate	632	—	156	—
Total real estate	4,409	20	5,792	—
Consumer:				
Equity loans and lines of credit	1,883	—	1,719	—
Consumer and installment	23	—	—	—
Total consumer	1,906	—	1,719	—
Total with no related allowance recorded	6,470	20	7,511	—
With an allowance recorded:				
Commercial:				
Commercial and industrial	—	—	1,589	32
Real estate:				
Owner occupied	—	—	1,322	30
Real estate construction and other land loans	3,832	68	5,695	85
Total real estate	3,832	68	7,017	115
Consumer:				
Equity loans and lines of credit	222	—	143	—
Total with an allowance recorded	4,054	68	8,749	147
Total	\$10,524	\$ 88	\$16,260	\$ 147

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	Six Months Ended June 30, 2014		Six Months Ended June 30, 2013	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:				
Commercial:				
Commercial and industrial	\$255	\$ —	\$ —	\$ —
Total commercial	255	—	—	—
Real estate:				
Owner occupied	2,911	41	137	—
Real estate construction and other land loans	1,349	—	5,488	—
Commercial real estate	554	—	130	—
Total real estate	4,814	41	5,755	—
Consumer:				
Equity loans and lines of credit	1,917	—	1,692	—
Consumer and installment	12	—	—	—
Total consumer	1,929	—	1,692	—
Total with no related allowance recorded	6,998	41	7,447	—
With an allowance recorded:				
Commercial:				
Commercial and industrial	498	—	1,803	65
Total commercial	498	—	1,803	65
Real estate:				
Owner occupied	55	—	1,402	30
Real estate construction and other land loans	3,923	138	5,612	170
Total real estate	3,978	138	7,014	200
Consumer:				
Equity loans and lines of credit	224	—	146	—
Consumer and installment	35	—	—	—
Total consumer	259	—	146	—
Total with an allowance recorded	4,735	138	8,963	265
Total	\$11,733	\$ 179	\$16,410	\$ 265

Foregone interest on nonaccrual loans totaled \$185,000 and \$378,000 for the six month periods ended June 30, 2014 and 2013, respectively. For the three month periods ended June 30, 2014 and 2013, foregone interest on nonaccrual loans totaled \$95,000 and \$216,000, respectively.

Troubled Debt Restructurings:

As of June 30, 2014 and December 31, 2013, the Company has a recorded investment in troubled debt restructurings of \$8,734,000 and \$10,366,000, respectively. The Company has allocated \$324,000 and \$946,000 of specific reserves to loans whose terms have been modified in troubled debt restructurings as of June 30, 2014 and December 31, 2013, respectively. The Company has committed to lend no additional amounts as of June 30, 2014 to customers with outstanding loans that are classified as troubled debt restructurings.

During the six month periods ended June 30, 2014 one loan was modified as a troubled debt restructuring. The modification of the terms of such loan included one or a combination of the following: a reduction of the stated

interest rate of the loan or an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk. During the same period, there were no troubled debt restructurings in which the amount of principal or accrued interest owed from the borrower were forgiven.

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The following table presents loans by class modified as troubled debt restructurings that occurred during the six months ended June 30, 2014 (in thousands):

Troubled Debt Restructurings:	Number of Loans	Pre-Modification Outstanding Recorded Investment (1)	Principal Modification (2)	Post Modification Outstanding Recorded Investment (3)	Outstanding Recorded Investment
Equity loans and line of credit	1	7	—	7	6

(1) Amounts represent the recorded investment in loans before recognizing effects of the TDR, if any.

Principal Modification includes principal forgiveness at the time of modification, contingent principal forgiveness (2) granted over the life of the loan based on borrower performance, and principal that has been legally separated and deferred to the end of the loan, with zero percent contractual interest rate.

(3) Balance outstanding after principal modification, if any borrower reduction to recorded investment.

The following table presents loans by class modified as troubled debt restructurings that occurred during the three months ended June 30, 2014 (in thousands):

Troubled Debt Restructurings:	Number of Loans	Pre-Modification Outstanding Recorded Investment (1)	Principal Modification (2)	Post Modification Outstanding Recorded Investment (3)	Outstanding Recorded Investment
Equity loans and line of credit	1	7	—	7	6

(1) Amounts represent the recorded investment in loans before recognizing effects of the TDR, if any.

Principal Modification includes principal forgiveness at the time of modification, contingent principal forgiveness (2) granted over the life of the loan based on borrower performance, and principal that has been legally separated and deferred to the end of the loan, with zero percent contractual interest rate.

(3) Balance outstanding after principal modification, if any borrower reduction to recorded investment.

A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms. There were no defaults on troubled debt restructurings, within twelve months following the modification, during the six months ended June 30, 2014 and June 30, 2013.

Note 6. Goodwill and Intangible Assets

Business combinations involving the Company's acquisition of the equity interests or net assets of another enterprise give rise to goodwill. Total goodwill at June 30, 2014 was \$29,917,000 consisting of \$14,643,000, \$8,934,000, and \$6,340,000 representing the excess of the cost of Service 1st Bancorp, Bank of Madera County, and Visalia Community Bank, respectively, over the net amounts assigned to assets acquired and liabilities assumed in the transactions accounted for under the purchase method of accounting. The value of goodwill is ultimately derived from the Company's ability to generate net earnings after the acquisitions and is not deductible for tax purposes. A decline in net earnings could be indicative of a decline in the fair value of goodwill and result in impairment. For that reason, goodwill is assessed at least annually for impairment.

The Company has selected September 30 as the date to perform the annual impairment test. Management assessed qualitative factors including performance trends and noted no factors indicating goodwill impairment.

Goodwill is also tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of the Company below its carrying amount. No such events or circumstances arose during the first six months of 2014.

The intangible assets at June 30, 2014 represent the estimated fair value of the core deposit relationships acquired in the 2013 acquisition of Visalia Community Bank of \$1,365,000, and Service 1st Bancorp in 2008 of \$1,400,000. Core deposit intangibles are being amortized by the straight-line method (which approximates the effective interest method) over an estimated life of seven to ten years from the date of acquisition. The carrying value of intangible assets at June 30, 2014 was \$1,512,000 net of \$1,253,000 in accumulated amortization expense. Management evaluates the remaining useful lives quarterly to determine whether events or circumstances warrant a revision to the remaining periods of amortization. Based on the evaluation, no changes to the remaining useful lives was required in the first quarter of 2014. Management performed an annual impairment test on core deposit intangibles as of September 30, 2013 and determined no impairment was necessary. Amortization expense recognized was \$168,000 and \$100,000 for the six month periods ended June 30, 2014 and 2013, respectively. Amortization expense recognized was \$84,000 and \$50,000 for the three month periods ended June 30, 2014 and 2013, respectively.

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The following table summarizes the Company's estimated core deposit intangible amortization expense for each of the next five years (in thousands):

Years Ending	Estimated Core Deposit Intangible Amortization
2014	\$ 169
2015	320
2016	137
2017	137
2018	137
Thereafter	612
	\$1,512

Note 7. Borrowing Arrangements

As of June 30, 2014 or December 31, 2013, the Company had no Federal Home Loan Bank (FHLB) of San Francisco advances.

FHLB advances are secured under the standard credit and securities-backed credit programs. Investment securities with amortized costs totaling \$1,657,000 and \$3,985,000, and market values totaling \$1,795,000 and \$4,084,000 at June 30, 2014 and December 31, 2013, respectively, were pledged under the securities-backed credit program. The Bank's credit limit varies according to the amount and composition of the investment and loan portfolios pledged as collateral.

As of June 30, 2014 and December 31, 2013, the Company had no Federal funds purchased.

Note 8. Income Taxes

The Company files its income taxes on a consolidated basis with its subsidiary. The allocation of income tax expense (benefit) represents each entity's proportionate share of the consolidated provision for income taxes. Deferred tax assets and liabilities are recognized for the tax consequences of temporary differences between the reported amounts of assets and liabilities and their tax bases. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment. On the consolidated balance sheets, net deferred tax assets are included in accrued interest receivable and other assets. The Company establishes a tax valuation allowance when it is more likely than not that a recorded tax benefit is not expected to be fully realized. The expense to create the tax valuation allowance is recorded as an additional income tax expense in the period the tax valuation allowance is created. Based on management's analysis as of June 30, 2014 and December 31, 2013, the Company maintained a deferred tax valuation allowance of \$108,000 related to California capital loss carryforwards.

Accounting for uncertainty in income taxes - The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying balance sheet along with any associated interest and penalties that would be payable to the taxing authorities upon examination. The Company recognizes accrued interest and penalties related to unrecognized tax benefits as a component of tax expense in the consolidated statements of income. During the six months ended June 30, 2014, the Company did not increase its reserve for uncertain tax positions attributable to tax credits and deductions related to enterprise zone activities in California. During the six months ended June 30, 2013, the Company increased its reserve for uncertain tax positions by \$15,000. Based on management's analysis as of June 30, 2014 and December 31, 2013, the Company determined that the deferred tax

valuation allowance in the amount of \$108,000 for California capital loss carryforwards was appropriate. The Company does not expect the total amount of unrecognized tax benefits to significantly increase or decrease in the next twelve months.

Note 9. Commitments and Contingencies

In the normal course of business, the Company is a party to financial instruments with off-balance sheet risk. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees,

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elements of credit and interest rate risk in excess of the amount recognized in the balance sheets. The contract or notional amounts of these instruments reflect the extent of involvement the Company has in particular classes of financial instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for loans.

Commitments to extend credit amounting to \$198,161,000 and \$192,667,000 were outstanding at June 30, 2014 and December 31, 2013, respectively. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract unless waived by the bank. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee.

Included in commitments to extend credit are undisbursed lines of credit totaling \$196,876,000 and \$191,072,000 at June 30, 2014 and December 31, 2013, respectively. Undisbursed lines of credit are revolving lines of credit whereby customers can repay principal and request principal advances during the term of the loan at their discretion and most expire between one and 12 months.

Included in undisbursed lines of credit are commitments for the undisbursed portions of construction loans totaling \$25,865,000 and \$26,402,000 as of June 30, 2014 and December 31, 2013, respectively. These commitments are agreements to lend to customers, subject to meeting certain construction progress requirements established in the contracts. The underlying construction loans have fixed expiration dates.

Standby letters of credit and financial guarantees amounting to \$1,285,000 and \$1,595,000 were outstanding at June 30, 2014 and December 31, 2013, respectively. Standby letters of credit and financial guarantees are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support private borrowing arrangements. Most standby letters of credit and guarantees carry a one year term or less. The fair value of the liability related to these standby letters of credit, which represents the fees received for their issuance, was not significant at June 30, 2014 and December 31, 2013. The Company recognizes these fees as revenue over the term of the commitment or when the commitment is used.

The Company generally requires collateral or other security to support financial instruments with credit risk. Management does not anticipate any material loss will result from the outstanding commitments to extend credit, standby letters of credit and financial guarantees. At June 30, 2014 and December 31, 2013, the balance of a contingent allocation for probable loan loss experience on unfunded obligations was \$109,000 and \$141,000, respectively. The contingent allocation for probable loan loss experience on unfunded obligations is calculated by management using an appropriate, systematic, and consistently applied process. While related to credit losses, this allocation is not a part of the allowance for credit losses and is considered separately as a liability for accounting and regulatory reporting purposes.

The Company is subject to legal proceedings and claims which arise in the ordinary course of business. In the opinion of management, the amount of ultimate liability with respect to such actions will not materially affect the consolidated financial position or consolidated results of operations of the Company.

Note 10. Earnings Per Share

Basic earnings per share (EPS), which excludes dilution, is computed by dividing income available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock, such as stock options, stock appreciation rights settled in stock or restricted stock awards, result in the issuance of common stock which shares in the earnings of the Company. A reconciliation of the numerators and denominators of the basic and diluted EPS computations is as follows:

Basic Earnings Per Share (In thousands, except share and per share amounts)	For the Three Months Ended June 30,		For the Six Months Ended June 30,		
	2014	2013	2014	2013	
Net Income	\$2,693	\$1,287	\$5,309	\$3,070	
Less: Preferred stock dividends and accretion	—	(88) —	(175)
Income available to common shareholders	\$2,693	\$1,199	\$5,309	\$2,895	

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Weighted average shares outstanding	10,918,065	9,587,376	10,917,010	9,573,257
Basic earnings per share	\$0.25	\$0.13	\$0.49	\$0.30

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Diluted Earnings Per Share (In thousands, except share and per share amounts)	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2014	2013	2014	2013
Net Income	\$2,693	\$1,287	\$5,309	\$3,070
Less: Preferred stock dividends and accretion	—	(88	) —	(175
Income available to common shareholders	\$2,693	\$1,199	\$5,309	\$2,895
Weighted average shares outstanding	10,918,065	9,587,376	10,917,010	9,573,257
Effect of dilutive stock options	81,598	57,562	79,562	56,514
Weighted average shares of common stock and common stock equivalents	10,999,663	9,644,938		