UNITED SECURITY BANCSHARES
Form 10-K
March 17, 2015

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

FORM 10-K

x	ANNUALREPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2014.
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: 000-32987

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

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

Registrant's telephone number, including area code (559) 248-4943
Securities registered pursuant to Section 12(b) of the Act: Common Stock, no par value on Nasdaq
(Title of Class)
Securities registered pursuant to Section 12(g) of the Act: NONE
Indicate by check mark whether the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes o No x
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Securities Act.
Yes o No x
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing for the past 90 days.
Yes x No o
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every
Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o
Indicate by check mark if disclosure of delinquent filers pursuant to item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrants knowledge, in the definitive proxy or information statements incorporated by reference in Part III of this form 10-K or any amendment to this Form 10-K. 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" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer o Accelerated filer o Non-accelerated filer o Small reporting company x

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

Aggregate market value of the Common Stock held by non-affiliates as of the last business day of the registrant's most recently completed second fiscal quarter - June 30, 2014: $59,326,341

Shares outstanding as of February 28, 2015: 15,425,086

DOCUMENTS INCORPORATED BY REFERENCE

Certain portions of the Definitive Proxy Statement for the 2015 Meeting of Shareholders is incorporated by reference into Part III. Part III, Items 10, 11, 12, 13 and 14

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PART 1

Certain matters discussed or incorporated by reference in this Annual Report of Form 10-K including, but not limited to, those described in "Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations", are forward-looking statements as defined under the Securities Litigation Reform Act of 1995 that are subject to risks and uncertainties that could cause actual results to differ materially from those projected in the forward-looking statements. Such risks and uncertainties include, among others, (1) competitive pressure in the banking industry increasing significantly; (2) changes in the interest rate environment which may reduce margins and devalue assets; (3) general economic conditions, either nationally or regionally, are less favorable than expected, resulting in, among other things, a deterioration in credit quality; (4) changes in the regulatory environment; (5) changes in business conditions and inflation; (6) changes in securities markets; (7) asset/liability matching risks and liquidity risks; (8) potential impairment of goodwill and other intangible assets; (9) loss of key personnel; and (10) operational interruptions including data processing systems failure and fraud. Therefore, the information set forth therein should be carefully considered when evaluating the business prospects of the Company.

Item 1 - Business

General

United Security Bancshares (the “Company”) is a California corporation incorporated during March of 2001 and is registered with the Board of Governors of the Federal Reserve System as a bank holding company under the Bank Holding Company Act of 1956, as amended. The Company’s stock is listed on NASDAQ under the symbol “UBFO”. United Security Bank (the “Bank”) is a wholly-owned bank subsidiary of the Company and was formed in 1987. United Security Bancshares Capital Trust I (the “Trust”) was formed during June of 2001 as a Delaware business trust for the sole purpose of issuing Trust Preferred securities. The Trust was originally formed as a subsidiary of the Company, but was deconsolidated during 2004 pursuant to the adoption of ASC 810 (as revised), “Consolidation of Variable Interest Entities." During July 2007, the Trust Preferred Securities issued under USB Capital Trust I were redeemed, and upon retirement, the USB Capital Trust I was dissolved. During July 2007, the Company formed United Security Bancshares Capital Trust II and issued $15.0 million in Trust Preferred Securities with terms similar to those originally issued under USB Capital Trust I, except at a lower interest rate. At present, the Company does not engage in any material business activities other than ownership of the Bank.

United Security Bank

On June 12, 2001, the Bank became the wholly-owned subsidiary of United Security Bancshares through a tax-free holding company reorganization, accounted for on a basis similar to the pooling of interest method. In the transaction, each share of Bank stock was exchanged for a share of Company stock on a one-to-one basis.

The Bank is a California state-chartered bank headquartered in Fresno, California. It is also a member of the Federal Reserve System (“Fed member”). The Bank originally commenced business on December 21, 1987, as a national bank and, during the fourth quarter of 1998, filed an application with the California Department of Financial Institutions and other regulatory authorities to become a state-chartered bank. The shareholders approved the conversion in January of 1999, and the Bank was granted approval to operate as a state-chartered bank on February 3, 1999. The Bank’s operations are currently subject to federal and state laws applicable to state-chartered, Fed member banks, and its deposits are insured up to the applicable limits by the Federal Deposit Insurance Corporation (FDIC). The Bank is also subject to the Federal Deposit Insurance Act and regulatory reporting requirements of the FDIC. As a state-chartered bank and a member of the Federal Reserve System, the Bank is subject to supervision and regular examinations by the Board of Governors of the Federal Reserve System (FRB) and the California Department of

Business Oversight (DBO). In addition, the Bank is required to file reports with the FRB and provide such additional information as the FRB may require.

USB Investment Trust Inc. was incorporated effective December 31, 2001 as a special purpose real estate investment trust (REIT) under Maryland law. The REIT is a subsidiary of the Bank and was funded with $133.0 million in real estate-secured loans contributed by the Bank. USB Investment Trust was originally formed to give the Bank flexibility in raising capital, and reduce the expenses associated with holding the assets contributed to USB Investment Trust. For further discussion of the REIT, refer to Item 7 – Management's Discussion and Analysis of Financial Condition and Results of Operations – Income Taxes.

Effective April 23, 2004, the Company completed a merger with Taft National Bank headquartered in Taft, California. Taft National Bank (Taft) was merged into United Security Bank and Taft's two branches, one located in Taft and the other located in Bakersfield, California, operate as branches of United Security Bank. This transaction was accounted for using the purchase method of accounting, and resulted in the purchase price being allocated to the assets acquired and liabilities assumed from Taft based on the fair value of those assets and liabilities, with resultant goodwill of $1.6 million and core deposits intangibles of $1.9 million. Goodwill is not amortized but is reviewed at least annually for impairment, while core deposit intangibles were amortized over a period of 7 years. At the time of the merger, the Company sought opportunities to expand its market area to the south with the expectation that the Bakersfield area would have significant growth given its strategic location just north of Los Angeles. The Company believes there was no impairment on either the goodwill or core deposit intangible related to the Taft merger.

On February 16, 2007, the Company completed its merger with Legacy Bank, N.A., located in Campbell, California, with the acquisition of 100 percent of Legacy's outstanding common shares. At the time of the merger, Legacy Bank's one branch was merged with and into United Security Bank, a subsidiary of the Company. The purchase of Legacy Bank provided the Company with an opportunity to expand its market area into Santa Clara County and to serve a growing small business niche and individual client base built by Legacy. The Company believes that as the economy continues to recover from the recent significant downturn, there will be increased opportunities to expand business within the greater Campbell area particularly in lending to small-to-medium sized businesses, The merger transaction was accounted for as a purchase transaction, and resulted in the purchase price being allocated to the assets acquired and liabilities assumed from Legacy Bank based on the fair value of those assets and liabilities, with resultant goodwill of $8.8 million and core deposits intangibles of $1.9 million. Goodwill is not amortized but is reviewed at least annually for impairment, while core deposit intangibles are being amortized over a period of approximately 7 years. The Company recognized no impairment charges related to goodwill or core deposit intangibles for the years ended December 31, 2014 and 2013.

At December 31, 2014, the Bank operates three branches (including its main office), one construction lending office, and one financial services office in Fresno and one branch each, in Oakhurst, Caruthers, San Joaquin, Firebaugh, Coalinga, Bakersfield, Taft, and Campbell. In addition, the Company and Bank have administrative headquarters located at 2126 Inyo Street, Fresno, California, 93721. The Company operates as one operating segment.

At December 31, 2014 and 2013, the consolidated Company had total assets of approximately $663,169,000, and $635,929,000, respectively. For the year ended December 31, 2014, the Company reported net income of $6,216,000, as compared to $7,269,000 for the year ended December 31, 2013. At December 31, 2014, the consolidated Company had approximately $446,824,000 in net loans, $565,373,000 in deposits, and $82,826,000 in shareholders' equity.

The Company has increased loan growth over the last year as the economy and real estate markets have improved. While the company experienced a decline in loan growth between 2012 and 2013, the loan portfolio has grown significantly over the last year. Total loans declined 1.1% between December 31, 2012 and December 31, 2013, but increased 16.35% between December 31, 2013 and December 31, 2014. During the same periods, nonperforming assets and related loan losses both decreased. Nonperforming assets declined from $47,073,000 at December 31, 2012, to $32,048,000 at December 31, 2013 and declined an additional $2,462,000 to $29,586,000 at December 31, 2014, for a total reduction of $17,487,000 in nonperforming assets over the two periods. Loan loss provisions totaled $1,019,000 for the year ended December 31, 2012. Negative provisions were recorded for the years ended December 31, 2013, and December 31, 2014, of $1,098,000 and $845,000, respectively. Over the past year, housing starts have increased and housing prices in the Company's market area have improved. Unemployment and other economic factors continue to strengthen. As a result, Management's focus over the past year, has been to concentrate its efforts on developing new business and growing the loan portfolio. Lending policies and procedures have been enhanced, and loan modifications, including rate and maturity concessions, and forbearance agreements, continue to be utilized in order to minimize loss exposure in the loan portfolio.

While loan growth prior to 2007 was funded to some degree by brokered deposits and other wholesale funding sources, the current state of the economy and the financial condition of the Company have made it increasingly important to continue to develop core deposits and reduce the Company’s dependence on brokered and other wholesale funding sources, including lines of credit with the Federal Reserve Bank and the FHLB. The Company increased its efforts early in 2009 to develop core deposit growth with employee training throughout the entire organization and a deposit-gathering program that incented employees to bring in new deposits from our local market area and establish more extensive relationships with our customers. As a result, the Bank has reduced its dependence on wholesale funding sources, including brokered deposits, to a level more in-line with peers.

The Company's percentage of brokered deposits are now in-line with peers. Total brokered deposits decreased from $11,500,000 at December 31, 2013, to $11,480,000 at December 31, 2014, representing a slight decrease of $20,000. Through additions to the loan portfolio and securities purchases, the Company has lowered its liquidity positions with a decrease in fed funds sold and other overnight investments of $115,019,000 at December 31, 2013 to $82,229,000 at December 31, 2014.

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The following discussion of the Company's services should be read in conjunction with "MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS."

Bank Services

As a state-chartered commercial bank, United Security Bank offers a full range of commercial banking services primarily to the business and professional community and individuals located in Fresno, Madera, Kern, and Santa Clara Counties.

The Bank offers a wide range of deposit instruments including personal and business checking accounts and savings accounts, interest-bearing negotiable order of withdrawal (NOW) accounts, money market accounts and time certificates of deposit. Most of the Bank's deposits are comprised of accounts from individuals and from small and medium-sized business-related sources. Time deposits have provided a significant portion of the Bank’s deposit base amounting to 13.82% and 15.39% of total deposits at December 31, 2014 and 2013, respectively. A portion of those time deposits are brokered deposits which are considered wholesale funding sources generally from out of the Bank’s market area. Brokered deposits comprised 2.03% and 2.12% of total deposits at December 31, 2014 and 2013, respectively.

The Bank also engages in a full complement of lending activities, including real estate mortgage (46.9% of total loans at December 31, 2014), commercial and industrial (13.6% of total loans at December 31, 2014), real estate construction (30.0% of total loans at December 31, 2014), as well as agricultural (6.9% of total loans at December 31, 2014), and consumer loans (2.6% of total loans at December 31, 2014), with particular emphasis on short and medium-term obligations. Approximately 77% of the Bank's loans are secured by real estate at December 31, 2014. A loan may be secured (in whole or in part) by real estate even though the purpose of the loan is not to facilitate the purchase or development of real estate. At December 31, 2014, the Bank had loans (net of unearned fees) outstanding of $457,595,000, which represented approximately 80.9% of the Bank's total deposits and approximately 69.0% of its total assets.

Real estate mortgage loans are secured by deeds of trust primarily on commercial property. Repayment of real estate mortgage loans is generally from the cash flow of the borrower. Commercial and industrial loans have a high degree of industry diversification. Loans may be originated in the Company’s market area, or participated with other financial institutions outside the Company’s market area. A substantial portion of the Company’s commercial and industrial loans are secured by accounts receivable, inventory, leases or other collateral. The remainder are unsecured. However, extensions of credit are predicated on the financial capacity of the borrower to repay. Repayment of commercial loans is generally from the cash flow of the borrower. Real estate construction loans consist of loans to residential contractors, which are secured by single-family residential properties. All real estate loans have established equity requirements. Repayment of real estate construction loans is generally from long-term mortgages with other lending institutions. Agricultural loans are generally secured by land, equipment, inventory and receivables. Repayment of agricultural loans is generally from the expected cash flow of the borrower.

Although the Bank has a high concentration of commercial real estate loans, the Bank is not in the business of making residential mortgage loans to individuals. Residential mortgage loans totaled $59,095,000 or 12.91% of the portfolio at December 31, 2014. The Bank does not originate, or have in its loans portfolio, any subprime, Alt-A, or option adjustable rate loans. The Bank does originate interest-only loans which are generally revolving lines of credit to commercial and agricultural businesses or for real estate development where the borrowers business may be seasonal or cash flows may be restricted until the completion of the project. In addition, the Bank has restructured certain loans to allow the borrower to continue to perform on the loan under a troubled debt restructuring plan.

The Bank purchases loan participations from, and sells loan participations to, other financial institutions. The underwriting standards for loan participations or purchases are the same as non-participated loans, and are subject to the same limitations, collateral requirements, and borrower requirements. The Bank has reduced its level of loan participations over the past several years. Loan participations purchased comprised 0.01% of the total loan portfolio at December 31, 2013. Currently, the Bank holds no participation purchased loans. Loan participations sold comprised 1.4% and 2.5% of the total loan portfolio at December 31, 2014 and 2013, respectively. During the past year, participation lending activity has decreased and currently the Company is participating in few, if any, participation sales or purchases.

In the normal course of business, the Bank makes various loan commitments and incurs certain contingent liabilities. At December 31, 2014 and 2013, loan commitments of the Bank totaled $109,234,000 and $65,272,000, respectively, and letters of credit totaled $3,800,000 and $2,001,000, respectively. Of the $109,234,000 in loan commitments outstanding at December 31, 2014, $15,989,000, or 14.6%, were for loans with maturities of one year or less. Due to the nature of the business of the Bank's customers, there are no seasonal patterns or absolute predictability to the utilization of unused loan commitments; therefore, the Bank is unable to forecast the extent to which these commitments will be exercised within the

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current year. The Bank does not believe that any such utilization will constitute a material liquidity demand. The Company does however have collateralized and uncollateralized lines of credit which could be utilized if such loan commitments were to be exercised in excess of normal expectations.

In addition to the loan and deposit services discussed above, the Bank also offers a wide range of specialized services designed to attract and service the needs of commercial customers and account holders. These services include online banking, mobile banking, safe deposit boxes, ATM services, payroll direct deposit, cashier's checks, traveler's checks, money orders, and foreign drafts. In addition, the Bank offers a variety of specialized financial services, including wealth management, employee benefit, insurance and loan products, as well as consulting services for a variety of clients. The Bank does not operate a trust department; however, it makes arrangements with its correspondent bank to offer trust services to its customers upon request. Most of the Bank's business originates within Fresno, Madera, Kern, and Santa Clara Counties. Neither the Bank’s business nor liquidity are seasonal, and there has been no material effect upon the Bank's capital expenditures, earnings or competitive position as a result of federal, state or local environmental regulation.

Lending Policies

The following is a summary of the Bank’s loan policies.
Loan Documentation – All loan documentation is prepared by a centralized loan servicing department or by legal counsel based on the terms contained in the approved Credit Authorizations. The documentation, upon completion, is reviewed by a third party (Bank employee) in the loan servicing department prior to forwarding to the relationship managers, who then review the documents to ensure that they have been correctly prepared in accordance with the credit approval before execution by the borrowers.
Purchased Participations – The Bank independently underwrites, using the Bank’s same guidelines for direct originations, and reviews the loan documentation of participation loans originated by other lenders for acceptability.
Verification of Information – The Bank, principally a commercial business lender, has not and does not make any “No Doc” or “Stated Income” loans. In the underwriting of a commercial loan request, the Bank performs an enterprise analysis of the financial information for trends, verifies major assets and liabilities, and obtains Dun and Bradstreet Credit reports on the entities and credit bureau reports on the principals of the entity.
The Company is not dependent on any individual customer, entity, or group of related entities for deposits nor on any significant percentage of loans to borrowers.
Unsecured - Whether unsecured or secured, guarantees are usually obtained from the principals or from 3rd party guarantors if necessary for additional financial support. Unsecured loans totaled $35,626,000 and $46,982,000 at December 31, 2014 and 2013, respectively.
Historic policy on renewals - The renewal or extension of existing performing lines of credit or loans has not been changed; the credits are re-underwritten for the renewal period. The restructure or renewal of substandard loans is certified to the Board of Directors that the renewal is necessary to improve and protect the Bank’s ultimate interest in the collection of the credit or maximize its potential for collection, that the renewal reflects prudent underwriting based on reasonable repayment terms and is adequately secured, that the Bank has performed a comprehensive credit analysis indicating the borrower has the willingness and ability to repay the debt as per the terms of the restructure plan and that the Bank’s Loan Committee, designated by the Board, believes that the renewal will be repaid in accordance with the terms.
Additional Loans to nonaccrual borrowers. – The Bank as a general rule does not make additional loans to borrowers that are past due in principal or interest more than 90-days. However, in selected and limited instances as part of the workout or restructure of non-performing assets, to effect repayment, additional secured advances may be made.
Lending Limits – The Bank approves revolving lines of credit or loans for each borrower with terms and limits. Consideration is given for the aggregate direct borrowing exposure of the borrower, as well as, their indirect liability, plus the indirect liability of any guarantor. Overall, the Bank has established normal “House” lending limits at 50% of the Legal Lending Limit. The Legal Lending Limit is calculated for unsecured loans at 15% of total regulatory

capital, and for secured loans at 25% of total regulatory capital. The Board of Directors must approve any borrowing relationship that exceeds the House Lending Limit.

Competition and Market Share

The banking business in California generally, and in the market area served by the Company specifically, is highly competitive with respect to both loans and deposits. The Company competes for loans and deposits with other commercial banks, savings

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and loan associations, finance companies, money market funds, credit unions and other financial institutions, including a number that are substantially larger than the Company. Deregulation of the banking industry, increased competition from non-bank entities for the cash balances of individuals and businesses, and continuing developments in the computer and communications industries have had, and most likely will continue to have, a significant impact on the Company's competitive position. With the enactment of interstate banking legislation in California, bank holding companies headquartered outside of California will continue to enter the California market and provide competition for the Company. Additionally, with the Gramm-Leach-Bliley Act of 1999, traditional competitive barriers between insurance companies, securities underwriters, and commercial banks have been eased, allowing a greater number of financial intermediaries to offer a wider assortment of financial services. Many of the major commercial banks operating in the Company's market areas offer certain services such as trust and international banking services, which the Company does not offer directly. In addition, banks with larger capitalization have larger lending limits and are thereby able to serve larger customers.

The Company’s primary market area at December 31, 2014 was located in Fresno, Madera, and Kern Counties, in which approximately 30 FDIC-insured financial institutions compete for business. Santa Clara County was added during February 2007, with the Legacy Bank acquisition, in which approximately 50 FDIC-insured financial institutions compete for business. The following table sets forth information regarding deposit market share and ranking by county as of June 30, 2014, which is the most current information available.

	Rank	Share
Fresno County	8th	3.58%
Madera County	10th	4.01%
Kern County	14th	1.02%
Total of Fresno, Madera, Kern Counties	12th	2.67%
Santa Clara County	42nd	0.02%

Supervision and Regulation

The Company

The Company is a bank holding company within the meaning of the Bank Holding Company Act of 1956, as amended (the “BHC Act”), and is registered as such with the FRB. A bank holding company is required to file annual reports with the FRB. Information regarding its business operations and those of its subsidiaries and is also subject to examination by the FRB.

The BHC Act requires, among other things, prior approval before acquiring, directly or indirectly, ownership or control of any voting shares of any bank, if after such acquisition it would directly or indirectly own or control more than 5% of the voting stock of that bank, unless it already owns a majority of the voting stock of that bank. The BHC Act also provides that the FRB shall not approve any acquisition that would result in or further the creation of a monopoly, or the effect of which may be substantially to lessen competition, unless the anticompetitive effects of the proposed transaction are clearly outweighed by the probable effect in meeting the convenience and needs of the community served.

Furthermore, under the BHC Act, a bank holding company is, with limited exceptions, prohibited from (i) acquiring direct or indirect ownership or control of more than 5% of the voting shares of any company which is not a bank or (ii) engaging in any activity other than managing or controlling banks. With the prior approval of the FRB, however, a bank holding company may own shares of a company engaged in activities which the FRB has determined to be so closely related to banking or managing or controlling banks as to be proper incident thereto. Amendments to the BHC Act expand the circumstances under which a bank holding company may acquire control of all or substantially all of the assets of a bank located outside the State of California.

The BHC Act requires a bank holding company to serve as a source of financial and managerial strength to its subsidiary banks. It is the FRB's policy that a bank holding company should stand ready to use available resources to provide adequate capital funds to subsidiary banks during periods of financial stress and should maintain the financial flexibility and capital raising capacity to obtain additional resources for assisting a subsidiary bank. Under certain conditions, the FRB may conclude that certain actions of a bank holding company, such as payment of cash dividends, would constitute unsafe and unsound banking practices because they violate the FRB's "source of strength" doctrine.

A bank holding company and its subsidiaries are prohibited from certain tie-in arrangements in connection with any extension of credit, sale or lease of property or furnishing of services. For example, with certain exceptions, a bank may not condition an

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extension of credit on a promise by its customer to obtain other services by it, its holding company or other subsidiaries, or on a promise by its customer not to obtain services from a competitor. In addition, federal law imposes certain restrictions between the Company and its subsidiaries, including the Bank. As an affiliate of the Bank, the Company is subject, with certain exceptions, to provisions of federal law imposing limitations on, and requiring collateral for, extensions of credit by the Bank to its affiliates.

As a public company, United Security Bancshares is subject to the Sarbanes-Oxley Act of 2002. The Sarbanes-Oxley Act amends the Securities and Exchange Act of 1934, and is intended to protect investors by, among other things, improving the reliability of financial reporting, increasing management accountability, and increasing the independence of Directors and the Company's external accountants.

The Company is subject to the periodic reporting requirements of the Securities Exchange Act of 1934, as amended, which include but are not limited to the filing of annual, quarterly and other current reports with the SEC.

The Bank

The Bank as a state-chartered bank and a member of the Federal Reserve, is subject to regulation, supervision and regular examination by the FRB, the California Department of Business Oversight (DBO) and the Consumer Financial Protection Bureau (CFPB.) The Bank is subject to California laws, insofar as they are not preempted by federal banking law. Deposits of the Bank are insured by the FDIC up to the applicable limits in an amount up to $250,000 per customer, and, as such, the Bank is subject to the regulations of the FDIC and the Federal Deposit Insurance Act. As a consequence of the extensive regulation of commercial banking activities in California and the United States, the Bank's business is particularly susceptible to changes in California and federal legislation and regulation, which may have the effect of increasing the cost of doing business, limiting permissible activities or increasing competition.

Various other requirements and restrictions under the laws of the United States and the State of California affect the operations of the Bank. Federal and California statutes and regulations relate to many aspects of the Bank's operations, including capital requirements and disclosure requirements to depositors and borrowers, requirements to maintain reserves against deposits, limitations on interest rates payable on deposits, loans, investments, and restrictions on borrowings and on payment of dividends. The DBO regulates the number and location of branch offices of a state-chartered bank, and may permit a bank to maintain branches only to the extent allowable under state law for state banks. California law presently permits a bank to locate a branch in any locality in the state. Additionally, California law exempts banks from California usury laws.

Capital Standards. The FRB has risk-based capital adequacy guidelines intended to provide a measure of capital adequacy that reflects the degree of risk associated with a banking organization's operations for both transactions reported on the balance sheet as assets, and transactions, such as letters of credit and recourse arrangements, which are reported as off-balance-sheet items. Under these guidelines, nominal dollar amounts of assets and credit equivalent amounts of off-balance-sheet items are multiplied by one of several risk adjustment percentages, which range from 0% for assets with low credit risk, such as certain U.S. government securities, to 100% for assets with relatively higher credit risk, such as business loans.

A banking organization's risk-based capital ratios are obtained by dividing its qualifying capital by its total risk-adjusted assets and off-balance-sheet items. The regulators measure risk-adjusted assets and off-balance-sheet items against both total qualifying capital (the sum of Tier 1 capital and limited amounts of Tier 2 capital) and Tier 1 capital. Tier 1 capital consists of common stock, retained earnings, noncumulative perpetual preferred stock and minority interests in certain subsidiaries, less most other intangible assets. Tier 2 capital may consist of a limited amount of the allowance for loan and lease losses and certain other instruments with some characteristics of equity. The inclusion of elements of Tier 2 capital is subject to certain other requirements and limitations of the federal banking agencies. Since December 31, 1992, the FRB and the FDIC have required a minimum ratio of qualifying total capital to risk-adjusted assets and off-balance-sheet items of 8%, and a minimum ratio of Tier 1 capital to risk-adjusted assets and off-balance-sheet items of 4%.

In addition to the risk-based guidelines, the FRB requires banking organizations to maintain a minimum amount of Tier 1 capital to average total assets, referred to as the leverage ratio. For a banking organization rated in the highest of the five categories used by regulators to rate banking organizations, the minimum leverage ratio of Tier 1 capital to total assets is 3%. It is improbable; however, that an institution with a 3% leverage ratio would receive the highest rating by the regulators since a strong capital position is a significant part of the regulators' ratings. For all banking organizations not rated in the highest category, the minimum leverage ratio is 4%. In addition to these uniform risk-based capital guidelines and leverage ratios that apply across the industry, the FRB and FDIC have the discretion to set individual minimum capital requirements for specific institutions at rates significantly above the minimum guidelines and ratios.

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A bank that does not achieve and maintain the required capital levels may be issued a capital directive by the FDIC to ensure the maintenance of required capital levels. As discussed above, the Company is required to maintain certain levels of capital, as is the Bank. The regulatory capital guidelines as well as the actual capitalization for the Bank and the Company as of December 31, 2014 are as follows:

	Requirement to be:		December 31, 2014	
	Adequately Capitalized	Well Capitalized	Company	Bank
Tier 1 leverage capital ratio	4.0%	5.0%	12.49%	12.25%
Tier 1 risk-based capital ratio	4.0%	6.0%	16.03%	15.65%
Total risk-based capital ratio	8.0%	10.0%	17.29%	16.91%

New Capital Rules. On July 2, 2013, the FRB approved the final rules implementing the Basel Committee on Banking Supervision's capital guidelines for U.S. banks. Under the final rules, minimum requirements will increase for both the quantity and quality of capital held by the Company. The rules include a new common equity Tier 1 capital to risk-weighted assets ratio of 4.5% and a common equity Tier 1 capital conservation buffer of 2.5% of risk-weighted assets. The final rules also raise the minimum ratio of Tier 1 capital to risk-weighted assets from 4.0% to 6.0% and require a minimum leverage ratio of 4.0%. The final rules also implement strict eligibility criteria for regulatory capital instruments. On July 9, 2013, the FDIC also approved, as an interim final rule, the regulatory capital requirements for U.S. banks, following the actions of the FRB. The FDIC's rule is identical in substance to the final rules issued by the FRB.

The phase-in period for the final rules will begin for the Company on January 1, 2015, with full compliance with all of the final rule's requirements phased in over a multi-year schedule. Management believes that as of December 31, 2014, the Company's capital levels would remain "well-capitalized" under the new rules.

Prompt Corrective Action. Federal banking agencies possess broad powers to take corrective and other supervisory action to resolve the problems of insured depository institutions, including those institutions that fall below one or more prescribed minimum capital ratios described above. An institution that, based upon its capital levels, is classified as well capitalized, adequately capitalized, or undercapitalized may be treated as though it were in the next lower capital category if the appropriate federal banking agency, after notice and opportunity for hearing, determines that an unsafe or unsound condition or an unsafe or unsound practice warrants such treatment. At each successive lower capital category, an insured depository institution is subject to more restrictions.

In addition to measures taken under the prompt corrective action provisions, commercial banking organizations may be subject to potential enforcement actions by the federal regulators for unsafe or unsound practices in conducting their businesses or for violations of any law, rule, regulation, or any condition imposed in writing by the agency or any written agreement with the agency. Enforcement actions may include the imposition of a conservator or receiver, the issuance of a cease-and-desist order that can be judicially enforced, the termination of insurance of deposits (in the case of a depository institution), the imposition of civil money penalties, the issuance of directives to increase capital, the issuance of formal and informal agreements, the issuance of removal and prohibition orders against institution-affiliated parties and the enforcement of such actions through injunctions or restraining orders based upon a judicial determination that the agency would be harmed if such equitable relief was not granted. Additionally, a holding company’s inability to serve as a source of strength to its subsidiary banking organizations could serve as an additional basis for a regulatory action against the holding company.

Premiums for Deposit Insurance. The deposit insurance fund of the FDIC insures our customer deposits up to prescribed limits for each depositor. The Federal Deposit Insurance Reform Act of 2005 (“Reform Act”) and the Federal Deposit Insurance Reform Conforming Amendments Act of 2005 amended the insurance of deposits by the

FDIC and collection of assessments from insured depository institutions for deposit insurance. The base assessment rates under the Reform Act ranged from $0.02 to $0.40 per $100 of deposits annually. Implementing the Reform Act, the FDIC approved a final rule in 2006 and amended the rule in February 2009 that sets an insured depository institution's assessment rate on different factors that pose a risk of loss to the Deposit Insurance Fund, including the institution's recent financial ratios and supervisory ratings, and level of reliance on a significant amount of secured liabilities or significant amount of brokered deposits (except that the factor of brokered deposits will not be considered for well capitalized institutions that are not accompanied by rapid growth). The FDIC also in February 2009 set the assessment base rates to range between $0.12 to $0.16 per $100 of insured deposits on an annual basis. In May 2009, the FDIC imposed a special assessment of 5 basis points on each insured depository institution's assets less its Tier 1 capital payable on September 30, 2009 with a ceiling of 10 basis points of an institution's domestic deposits. In November 2009, the FDIC approved a final rule to require all insured depository institutions including the Bank to prepay three years (and

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ratably expense over three years) of FDIC assessments in the fourth quarter of 2009, except in the event such prepayment is waived by the FDIC.

In October 2010, the FDIC under the Dodd-Frank Act adopted a new DIF restoration plan to ensure that the fund reserve ratio reaches 1.35% by September 30, 2020. Under the new restoration plan, the FDIC will forego the uniform three-basis point increase in initial assessment rates schedules for January 1, 2011 and maintain the current schedule of assessment rates. At least semi-annually, the FDIC will update its loss and income projections for the DIF and, if needed, increase or decrease assessment rates. On February 7, 2011, the FDIC adopted a final rule modifying the risk-based assessment system from a domestic deposit base to a scorecard based assessment system, effective April 1, 2011. Effective as of April 1, 2011, the Bank was categorized as a small institution as the Bank has less than $10 billion in assets. The initial base assessment rates range from five to 35 basis points. After potential adjustments related to unsecured debt and brokered deposit balances, the final total assessment rates range from 2.5 to 45 basis points. Initial base assessment rates for small institutions ranged from five to 35 basis points. The Bank's assessment rate for 2011 fell at the high end of this range. Any material increase in assessments or the assessment rate could have a material adverse effect on our business, financial condition, results of operations or cash flows, depending on the amount of the increase. Furthermore, the FDIC is authorized to raise insurance premiums under certain circumstances.

In 2006, the Reform Act increased the deposit insurance limit for certain retirement plan deposit accounts from $100,000 to $250,000. The basic insurance limit for other deposits, including individuals, joint account holders, businesses, government entities, and trusts, remained at $100,000. The Reform Act also provided for the merger of the two deposit insurance funds administered by the FDIC, the Bank Insurance Fund ("BIF") and the Savings Association Insurance Fund ("SAIF"), into the DIF. On October 3, 2008, the EESA temporarily raised the basic limit on federal deposit insurance coverage from $100,000 to $250,000 per depositor. While the basic deposit insurance limit was to have returned to $100,000 after December 31, 2009, the Helping Families Save Their Homes Act extended the temporary increase in the standard maximum deposit insurance amount to $250,000 per depositor through December 31, 2013, and the enactment of the Dodd-Frank Act permanently raises the current standard maximum federal deposit insurance amount from $100,000 to $250,000 per qualified account.

In November 2008, the FDIC approved the final ruling establishing the Transaction Account Guarantee Program ("TAGP") as part of the Temporary Liquidity Guarantee Program ("TLGP"). Under this program, all non-interest bearing transaction accounts became fully guaranteed by the FDIC for the entire amount in the account. This unlimited coverage also extended to NOW (interest bearing deposit accounts) earning an interest rate no greater than 0.50% and all IOLTAs (lawyers' trust accounts). TAGP was extended with the enactment of the Dodd-Frank Act provides for unlimited deposit insurance for noninterest bearing transactions accounts (excluding NOW, but including IOLTAs) expiring on December 31, 2012.

The FDIC is authorized to terminate a depository institution's deposit insurance upon a finding by the FDIC that the institution's financial condition is unsafe or unsound or that the institution has engaged in unsafe or unsound practices or has violated any applicable rule, regulation, order or condition enacted or imposed by the institution's regulatory agency. The termination of deposit insurance for the bank would have a material adverse effect on our business, financial condition, results of operations and/or cash flows.

Federal Home Loan Bank System. The Bank is a member of the Federal Home Loan Bank of San Francisco (the "FHLB-SF"). Among other benefits, each Federal Home Loan Bank ("FHLB") serves as a reserve or central bank for its members within its assigned region. Each FHLB is financed primarily from the sale of consolidated obligations of the FHLB system. Each FHLB makes available loans or advances to its members in compliance with the policies and procedures established by the Board of Directors of the individual FHLB. The FHLB-SF utilizes a single class of stock with a par value of $100 per share, which may be issued, exchanged, redeemed and repurchased only at par value. As an FHLB member, the Bank is required to own FHLB –SF capital stock in an amount equal to the greater of:

a membership stock requirement with an initial cap of $25 million (100% of “membership asset value” as defined), or
an activity based stock requirement (based on percentage of outstanding advances).

The FHLB – SF capital stock is redeemable on five years written notice, subject to certain conditions. At December 31, 2014 the Bank owned 20,750 shares of the FHLB-SF capital stock.

Federal Reserve. The FRB requires all depository institutions to maintain non-interest bearing reserves at specified levels against their transaction accounts and non-personal time deposits. At December 31, 2014, the Bank was in compliance with these requirements.

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Regulatory Agreement with the Federal Reserve Bank of San Francisco

On March 23, 2010, United Security Bancshares (the "Company") and its wholly owned subsidiary, United Security Bank (the "Bank"), entered into a formal written agreement (the “Agreement”) with the Federal Reserve Bank of San Francisco (the “Federal Reserve”) as a result of a regulatory examination that was conducted by the Federal Reserve and the California Department of Financial Institutions (the “DFI”) in June 2009. That examination found significant increases in nonperforming assets, both classified loans and OREO, during 2008 and 2009, and heightened concerns about the Bank’s use of brokered and other wholesale funding sources to fund loan growth, which created increased risk to equity capital and potential volatility in earnings.

Under the terms of the Agreement, the Company and the Bank agreed, among other things: to maintain a sound process for determining, documenting, and recording an adequate allowance for loan and lease losses; to improve the management of the Bank's liquidity position and funds management policies; to maintain sufficient capital at the Company and Bank level; and to improve the Bank’s earnings and overall condition. The Company and Bank also agreed not to increase or guarantee any debt, purchase or redeem any shares of stock, declare or pay any cash dividends, or pay interest on the Company's junior subordinated debt or trust preferred securities, without prior written approval from the Federal Reserve. The Company generates no revenue of its own and, as such, relies on dividends from the Bank to pay its operating expenses and interest payments on the Company’s junior subordinated debt.

Effective November 19, 2014, the Federal Reserve terminated the Agreement with the Bank and the Company and replaced it with an informal supervisory agreement that requires, among other things, obtaining written approval from the Federal Reserve prior to the payment of dividends from the Bank to the Company or the payment of dividends by the Company or interest on the Company’s junior subordinated debt. The inability of the Bank to pay cash dividends to the Company may hinder the Company’s ability to meet its ongoing operating obligations.

Regulatory Order from the California Department of Business Oversight

On May 20, 2010, the DFI (now known as the Department of Business Oversight (the “DBO”)) issued a formal written order (the “Order”) pursuant to a consent agreement with the Bank as a result of the same June 2009 joint regulatory examination. The terms of the Order were essentially similar to the Federal Reserve’s Agreement, except for a few additional requirements.

On September 24, 2013, the Bank entered into an informal Memorandum of Understanding (the “MOU”) with the DBO and on October 15, 2013, the Order was terminated. The Order and the MOU require the Bank to maintain a ratio of tangible shareholder’s equity to total tangible assets equal to or greater than 9.0% and also requires the DBO’s approval for the Bank to pay a dividend to the Company.

Accordingly, reflecting the Company’s and the Bank’s improved financial condition and performance, as of November 19, 2014, the Bank and the Company have been relieved of all formal regulatory agreements. Some of the governance and procedures established by the Agreement and the Order remain in place, including submission of certain plans and reports to the Federal Reserve and DBO, the Bank’s obligation to maintain a 9.0% tangible shareholder’s equity ratio, and the requirement to seek approvals from the Federal Reserve and the DBO for either the Bank or the Company to pay dividends and for the Company to pay interest on its outstanding junior subordinated debt. While no assurances can be given as to future regulatory approvals, over the last three quarters the DBO and the Federal Reserve have been approving the Bank's payment of dividends to the Company to cover the Company's operating expenses and its interest payments and the Company's payment of quarterly interest on the junior subordinated debt.

Effect of Governmental Policies and Recent Legislation

Banking has traditionally been a business that depends on rate differentials. In general, the difference between the interest rate paid by the Company on its deposits and other borrowings and the interest rate received on loans extended to its customers and securities held in the Company's portfolio comprise the major portion of the Company's earnings. These rates are highly sensitive to many factors which are beyond the control of the Company. Accordingly, the earnings and growth of the Company are subject to the influence of domestic and foreign economic conditions, including, but not limited to, inflation, recession and unemployment.

Impact of Monetary Policies. The earnings and growth of the Company are affected not only by general economic conditions, both domestic and foreign, but also by the monetary and fiscal policies of the United States government and its agencies, particularly the Federal Reserve Board (“FRB”). The FRB implements national monetary policies (with objectives such as to curb inflation and combat recession) by its open market operations in United States Government securities, by adjusting the required level of reserves for financial institutions subject to reserve requirements, and by varying the discount rates applicable

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to borrowing by banks which are members of the Federal Reserve System. The actions of the FRB in these areas influence the growth of bank loans, investments and deposits and also affect interest rates charged on loans and paid on deposits. The FRB's policies have had a significant effect on the operating results of commercial banks and are expected to continue to do so in the future. The nature and timing of any future changes in monetary policies are not predictable. In addition, adverse economic conditions could make a higher provision for loan losses a prudent course and could cause higher loan charge-offs, thus adversely affecting the Company's net income.

Extensions of Credit to Insiders and Transactions with Affiliates. The Federal Reserve Act and FRB Regulation O place limitations and conditions on loans or extensions of credit to:

a bank's or bank holding company's executive officers, directors and principal shareholders (i.e., in most cases, those persons who own, control or have power to vote more than 10% of any class of voting securities),
any company controlled by any such executive officer, director or shareholder, or
any political or campaign committee controlled by such executive officer, director or principal shareholder.

Loans and leases extended to any of the above persons must comply with loan-to-one-borrower limits, require prior full board approval when aggregate extensions of credit to the person exceed specified amounts, must be made on substantially the same terms (including interest rates and collateral) as, and follow credit-underwriting procedures that are not less stringent than, those prevailing at the time for comparable transactions with non-insiders, and must not involve more than the normal risk of repayment or present other unfavorable features. In addition, Regulation O provides that the aggregate limit on extensions of credit to all insiders of a bank as a group cannot exceed the bank's unimpaired capital and unimpaired surplus. Regulation O also prohibits a bank from paying an overdraft on an account of an executive officer or director, except pursuant to a written pre-authorized interest-bearing extension of credit plan that specifies a method of repayment or a written pre-authorized transfer of funds from another account of the officer or director at the bank.

Consumer Protection Laws and Regulations. The banking regulatory agencies are focusing greater attention on compliance with consumer protection laws and their implementing regulations. Examination and enforcement have become more intense in nature, and insured institutions have been advised to monitor carefully compliance with such laws and regulations. The Company is subject to many federal and state consumer protection and privacy statutes and regulations, some of which are discussed below.

The Community Reinvestment Act (the "CRA") is intended to encourage insured depository institutions, while operating safely and soundly, to help meet the credit needs of their communities. The CRA specifically directs the federal regulatory agencies, in examining insured depository institutions, to assess a bank's record of helping meet the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with safe and sound banking practices. The CRA further requires the agencies to take a financial institution's record of meeting its community credit needs into account when evaluating applications for, among other things, domestic branches, mergers or acquisitions, or holding company formations. The agencies use the CRA assessment factors in order to provide a rating to the financial institution. The ratings range from a high of "outstanding" to a low of "substantial noncompliance." In its last examination for CRA compliance, as of October 2012, the Bank was rated "satisfactory."

The Equal Credit Opportunity Act (the "ECOA") generally prohibits discrimination in any credit transaction, whether for consumer or business purposes, on the basis of race, color, religion, national origin, sex, marital status, age (except in limited circumstances), receipt of income from public assistance programs, or good faith exercise of any rights under the Consumer Credit Protection Act.

The Truth in Lending Act (the "TILA") is designed to ensure that credit terms are disclosed in a meaningful way so that consumers may compare credit terms more readily and knowledgeably. As a result of the TILA, all creditors must use the same credit terminology to express rates and payments, including the annual percentage rate, the finance charge, the amount financed, the total of payments and the payment schedule, among other things. As a result of Dodd Frank, Regulation Z promulgated under TILA includes new limits on loan originator compensation for all closed-end mortgages. These changes include, prohibiting certain payments to a mortgage broker or loan officer based on the transaction's terms or conditions, prohibiting dual compensation, and prohibiting a mortgage broker or loan officer from ''steering'' consumers to transactions not in their interest, to increase mortgage broker or loan officer compensation.

The Fair Housing Act (the "FH Act") regulates many practices, including making it unlawful for any lender to discriminate in its housing-related lending activities against any person because of race, color, religion, national origin, sex, handicap or familial status. A number of lending practices have been found by the courts to be, or may be considered, illegal under the FH Act, including some that are not specifically mentioned in the FH Act itself.

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The Home Mortgage Disclosure Act (the "HMDA"), in response to public concern over credit shortages in certain urban neighborhoods, requires public disclosure of information that shows whether financial institutions are serving the housing credit needs of the neighborhoods and communities in which they are located. The HMDA also includes a "fair lending" aspect that requires the collection and disclosure of data about applicant and borrower characteristics as a way of identifying possible discriminatory lending patterns and enforcing anti-discrimination statutes.

The Right to Financial Privacy Act (the "RFPA") imposes a new requirement for financial institutions to provide new privacy protections to consumers. Financial institutions must provide disclosures to consumers of its privacy policy, and state the rights of consumers to direct their financial institution not to share their nonpublic personal information with third parties.

Finally, the Real Estate Settlement Procedures Act (the "RESPA") requires lenders to provide noncommercial borrowers with disclosures regarding the nature and cost of real estate settlements. Also, RESPA prohibits certain abusive practices, such as kickbacks, and places limitations on the amount of escrow accounts.

Penalties for noncompliance or violations under the above laws may include fines, reimbursement and other penalties. Due to heightened regulatory concern related to compliance with CRA, ECOA, TILA, FH Act, HMDA, RFPA and RESPA generally, the Company may incur additional compliance costs or be required to expend additional funds for investments in its local communities.

From time to time, legislation is enacted which has the effect of increasing the cost of doing business, limiting or expanding permissible activities or affecting the competitive balance between banks and other financial institutions. Proposals to change the laws and regulations governing the operations and taxation of banks and other financial institutions are frequently made in Congress, in the California legislature and before various bank regulatory agencies. The likelihood of any major change and the impact such change may have on the Company is impossible to predict. Certain of the potentially significant changes which have been enacted recently and other which are currently under consideration by Congress or various regulatory agencies or professional agencies are discussed below.

Recent Legislation and Other Changes

Federal and state laws affecting banking are enacted from time to time, and similarly federal and state regulations affecting banking are also adopted from time to time. The following include some of the recent laws and regulations affecting banking.

The Dodd-Frank Act, signed into law in July 2010, will significantly change the current bank regulatory structure and affect the lending, investment, trading and operating activities of financial institutions and their holding companies. The Dodd-Frank Act creates of a new interagency council, the Financial System Oversight Council that is charged with identifying and monitoring the systemic risk to the U.S. economy posed by systemically significant, large financial companies, including bank holding companies and non-bank financial companies. The Office of Thrift Supervision will be eliminated and its powers distributed among the Office of the Comptroller of the Currency, the Federal Reserve Board and the FDIC. The legislation also establishes a floor for capital of insured depository institutions that cannot be lower than the standards in effect today, and directs the federal banking regulators to implement new leverage and capital requirements within 18 months that take into account off-balance sheet activities and other risks, including risks relating to securitized products and derivatives.

The Dodd-Frank Act additionally created a new independent federal regulator to administer federal consumer protection laws. Among the provisions of the Dodd-Frank Act are the following:

Deposit Insurance

The Dodd-Frank Act permanently increased the maximum deposit insurance amount for banks, savings institutions and credit unions to $250,000 per depositor, retroactive to January 1, 2009. The Dodd-Frank Act also broadened the base for FDIC insurance assessments. Assessments are based on the average consolidated total assets less tangible equity capital of a financial institution. The Dodd-Frank Act requires the FDIC to increase the reserve ratio of the Deposit Insurance Fund from 1.15% to 1.35% of insured deposits by 2020 and eliminates the requirement that the FDIC pay dividends to insured depository institutions when the reserve ratio exceeds certain thresholds. The Dodd-Frank Act eliminated the federal statutory prohibition against the payment of interest on business checking accounts.

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Interstate Branching

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

Limits on Derivatives

The Dodd-Frank Act prohibits state-chartered banks from engaging in derivatives transactions unless the loans to one borrower limits of the state in which the bank is chartered take into consideration credit exposure to derivatives transactions. For this purpose, derivative transactions include any contract, agreement, swap, warrant, note or option that is based in whole or in part on the value of, any interest in, or any quantitative measure or the occurrence of any event relating to, one or more commodities securities, currencies, interest or other rates, indices or other assets.

Transactions with Affiliates and Insiders

The Dodd-Frank Act expanded the definition of “affiliate” for purposes of quantitative and qualitative limitations of Section 23A of the Federal Reserve Act to include mutual funds advised by a depository institution or its affiliates. The Dodd-Frank Act applies Section 23A and Section 22(h) of the Federal Reserve Act (governing transactions with insiders) to derivative transactions, repurchase agreements and securities lending and borrowing transactions that create credit exposure to an affiliate or an insider. Any such transactions with affiliates must be fully secured. The Dodd-Frank Act also prohibits an insured depository institution from purchasing an asset from or selling an asset to an insider unless the transaction is on market terms and, if representing more than 10% of capital, is approved in advance by disinterested directors.

Debit Card Interchange Fees

The Dodd-Frank Act requires that the amount of any interchange fee charged by a debit card issuer with respect to a debit card transaction must be reasonable and proportional to the cost incurred by the issuer. The FRB has established standards for reasonable and proportional fees which take into account the costs of preventing fraud. The restrictions on interchange fees, however, do not apply to banks that, together with their affiliates, have assets of less than $10 billion, such as the Bank.

Consumer Financial Protection Bureau

The Dodd-Frank Act created a new, independent federal agency called the Consumer Financial Protection Bureau (“CFPB”), which is granted broad rulemaking, supervisory and enforcement powers under various federal consumer financial protection laws, including the Equal Credit Opportunity Act, Truth in Lending Act, Real Estate Settlement Procedures Act, Fair Credit Reporting Act, Fair Debt Collection Act, the Consumer Financial Privacy provisions of the Gramm-Leach-Bliley Act and certain other statutes. The CFPB has examination and primary enforcement authority with respect to depository institutions with $10 billion or more in assets. Smaller institutions will be subject to rules promulgated by the CFPB but will continue to be examined and supervised by federal banking regulators for consumer compliance purposes. The CFPB has authority to prevent unfair, deceptive or abusive practices in connection with the offering of consumer financial products. The Dodd-Frank Act authorizes the CFPB to establish certain minimum standards for the origination of residential mortgages including a determination of the borrower’s ability to repay. In addition, the Dodd-Frank Act allows borrowers to raise certain defenses to foreclosure if they receive any loan other than a “qualified mortgage” as defined by the CFPB. The Dodd-Frank Act permits states to adopt consumer protection laws and standards that are more stringent than those adopted at the federal level and, in certain circumstances, permits state attorneys general to enforce compliance with both the state and federal laws and regulations.

The Electronic Funds Transfer Act (EFTA) provides a basic framework for establishing the rights, liabilities, and responsibilities of consumers who use electronic funds transfer (EFT) systems. The EFTA is implemented by the Federal Reserve's Regulation E, which governs transfers initiated through ATMs, point-of-sale terminals, payroll cards, automated clearinghouse (ACH) transactions, telephone bill-payment plans, or remote banking services. Regulation E was amended in January 2010 to require consumers to opt in (affirmatively consent) to participation in the Bank’s overdraft service program for ATM and one-time debit card transactions before overdraft fees may be assessed on the consumer’s account. Notice of the opt-in right must be provided to all existing and new customers who are consumers, and the customer’s affirmative consent must be obtained, before charges may be assessed on the consumer’s account for paying such overdrafts.

The rule provides bank customers with an ongoing right to revoke consent to participation in an overdraft service program for ATM and one-time debit card transactions, as opposed to being automatically enrolled in such a program. The rule also prohibits banks from conditioning the payment of overdrafts for checks, ACH transactions, or other types of transactions that overdraw the

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consumer's account on the consumer's opting into an overdraft service for ATM and one-time debit card transactions. For customers who do not affirmatively consent to overdraft service for ATM and one-time debit card transactions, a bank must provide those customers with the same account terms, conditions, and features that it provides to consumers who do affirmatively consent, except for the overdraft service for ATM and one-time debit card transactions.

On June 21, 2010, the federal banking agencies issued final guidance on incentive compensation which applies to all banks. Except for the largest banking organizations, enforcement of this guidance is handled through the supervisors' regular risk-focused examination process. . The employees covered by the final guidance are senior executives and others who are responsible for oversight of the organization's firm-wide activities or material business lines; individual employees, including non-executive employees, whose activities may expose the organization to material amounts of risk; and groups of employees who are subject to the same or similar incentive compensation arrangements and who, in the aggregate, may expose the organization to material amounts of risk, even if no individual employee is likely to expose the organization to material risk. The guidance provides for three principles for safe and sound incentive compensation arrangements:

- Balanced Risk-Taking: Incentive compensation arrangements should balance risk and financial results in a manner that does not encourage employees to expose their organizations to imprudent risks;

- Compatibility with Effective Controls and Risk-Management: A banking organization's risk-management processes and internal controls should reinforce and support the development and maintenance of balanced incentive compensation arrangements;

- Strong Corporate Governance: Banking organizations should have strong and effective corporate governance to help ensure sound compensation practices, including active and effective oversight by the board of directors.

In May 2009 the Helping Families Save Their Homes Act of 2009 was enacted to help consumers avoid mortgage foreclosures on their homes through certain loss mitigation actions including special forbearance, loan modification, pre-foreclosure sale, deed in lieu of foreclosure, support for borrower housing counseling, subordinate lien resolution, and borrower relocation. This law permits the Secretary of Housing and Urban Development (HUD), for mortgages either in default or facing imminent default, to: (1) authorize the modification of such mortgages; and (2) establish a program for payment of a partial claim to a mortgagee who agrees to apply the claim amount to payment of a mortgage on a 1- to 4-family residence. In implementing the law, the Secretary of HUD is authorized to (1) provide compensation to the mortgagee for lost income on monthly mortgage payments due to interest rate reduction; (2) reimburse the mortgagee from a guaranty fund in connection with activities that the mortgagee is required to undertake concerning repayment by the mortgagor of the amount owed to HUD; (3) make payments to the mortgagee on behalf of the borrower, under terms defined by HUD; and (4) make mortgage modification with terms extended up to 40 years from the modification date. The new law also authorizes the Secretary of HUD to: (1) reassign the mortgage to the mortgagee; (2) act as a Government National Mortgage Association (GNMA, or Ginnie Mae) issuer, or contract with an entity for such purpose, in order to pool the mortgage into a Ginnie Mae security; or (3) resell the mortgage in accordance with any program established for purchase by the federal government of insured mortgages. The law also amended the Foreclosure Prevention Act of 2008, with respect to emergency assistance for the redevelopment of abandoned and foreclosed homes (neighborhood stabilization), to authorize each state that has received certain minimum allocations and has fulfilled certain requirements, to distribute any remaining amounts to areas with homeowners at risk of foreclosure or in foreclosure without regard to the percentage of home foreclosures in such areas.

Also in May 2009, the Credit Card Act of 2009 was enacted to help consumers and ban certain practices of credit card issuers. This law allows interest rate hikes on existing balances only under limited conditions, such as when a promotional rate ends, there is a variable rate or if the cardholder makes a late payment. Interest rates on new transactions can increase only after the first year. Significant changes in terms on accounts cannot occur without 45 days' advance notice of the change. The law bans raising interest rates on customers based on their payment records with other unrelated credit issuers (such as utility companies and other creditors) for existing credit card balances, though card issuers would still be allowed to use universal default on future credit card balances if they give at least 45 days' advance notice of the change. The law allows consumers to opt out of certain significant changes in terms on their accounts. Opting out means cardholders agree to close their accounts and pay off the balance under the old terms. They have at least five years to pay the balance. Credit card issuers will be banned from issuing credit cards to anyone under 21, unless they have adult co-signers on the accounts or can show proof they have enough income to repay the card debt.

The law requires card issuers to give card account holders "a reasonable amount of time" to make payments on monthly bills. That means payments would be due at least 21 days after they are mailed or delivered. Credit card issuers would no longer be able to set early morning or other arbitrary deadlines for payments. When consumers have accounts that carry different interest rates for different types of purchases payments in excess of the minimum amount due must go to balances with higher interest rates first. Consumers must "opt in" to over-limit fees. Those who opt out would have their transactions rejected if they exceed their credit limits, thus avoiding over-limit fees. Fees charged for going over the limit must be reasonable. Finance charges on

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outstanding credit card balances would be computed based on purchases made in the current cycle rather than going back to the previous billing cycle to calculate interest charges. Fees on credit cards cannot exceed 25 percent of the available credit limit in the first year of the card.

On February 17, 2009, the American Recovery and Reinvestment Act of 2009 (ARRA) was enacted to provide stimulus to the struggling US economy. ARRA authorizes spending of $787 billion, including about $288 billion for tax relief, $144 billion for state and local relief aid, and $111 billion for infrastructure and science. In addition, ARRA includes additional executive compensation restrictions for recipients of funds from the US Treasury under the Troubled Assets Relief Program of the Emergency Economic Stimulus Act of 2008 (EESA).

EESA was amended by ARRA to provide additional incentive compensation restrictions for financial institutions receiving TARP funds and also require additional corporate governance provisions with respect to limiting golden parachutes, lavish expenditures and requiring officer certifications of compliance and clawbacks for improperly earned incentive compensation at such institutions.

In addition, EESA as amended by ARRA provides that for any TARP recipient, its annual meeting materials shall include a nonbinding shareholder approval proposal of executive compensation for shareholders to vote.

ARRA also provides $730 million to the SBA and makes changes to the agency’s lending and investment programs so that they can reach more small businesses that need help. The funding includes:

- $375 million for temporarily eliminating fees on SBA-backed loans and raising SBA's guarantee percentage on some loans to 90 percent.
- $255 million for a new loan program to help small businesses meet existing debt payments.
- $30 million for expanding SBA’s Microloan program, enough to finance up to $50 million in new lending and $24 million in technical assistance grants to microlenders

On January 1, 2012, SB 664 (Committee on Banking and Financial Institutions, Chapter 243, Statutes of 2011) became operative. While some substantive changes were included in this legislation due to the passage of the Dodd-Frank federal legislation and some technical corrections that resulted from earlier amendments to the Code, the majority of the work involved in SB 664 was to reorder the section numbering in the Code. Among other things, the law requires a bank that establishes a branch office in this state in accordance with the National Bank Act, as amended by the Dodd-Frank Act to provide a specified notice to the Commissioner of DBO within 10 days of the establishment, relocation, or redesignation of offices.

In 2010, California SB 931 was enacted and provides that the first lien holder of a California residential loan accepts as full payment and satisfaction of such lien after the successful completion of the short sale of such residence, and furthermore such lender is prevented from pursuing a deficiency against the noncorporate borrower. In 2011, the benefits of SB 931 was extended to such borrowers with a second or subordinate lien in SB458 where such lien holder agreed to the short sale.

In California, the enactment of AB329 in 2009, the Reverse Mortgage Elder Protection Act of 2009 prohibits a lender or any other person who participates in the origination of the mortgage from participation in, being associated with, or employing any party that participates in or is associated with any other financial or insurance activity or referring a prospective borrower to anyone for the purchase of other financial or insurance products; and imposes certain disclosure requirements on the lender.

The enactment of AB1160 in 2009, requires a supervised financial institution in California that negotiates primarily in any of a number of specified languages in the course of entering into a contract or agreement for a loan or extension of credit secured by residential real property, to deliver, prior to the execution of the contract or agreement, and no later than 3 business days after receiving the written application, a specified form in that language summarizing the terms of the contract or agreement; provides for administrative penalties for violations; and requires the California Department of Corporations and the DBO to create a form for providing translations and make it available in Spanish, Chinese, Tagalog, Vietnamese and Korean.

The enactment of AB 1291 in 2009 made changes to the California Unclaimed Property Law including (among other things): allowing electronic notification to customers who have consented to electronic notice; requiring that notices contain certain information and allow the holder to provide electronic means to enable the owner to contact the holder in lieu of returning the prescribed form to declare the owner’s intent; authorizing the holder to give additional notices; and requiring, beginning January 1, 2011, a banking or financial organization to provide a written notice regarding escheat at the time a new account or safe deposit box is opened.

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On February 20, 2009, Governor Schwarzenegger signed ABX2 7 and SBX2 7, which established the California Foreclosure Prevention Act. The California Foreclosure Prevention Act modifies the foreclosure process to provide additional time for borrowers to work out loan modifications while providing an exemption for mortgage loan servicers that have implemented a comprehensive loan modification program. Civil Code Section 2923.52 requires an additional 90 day period beyond the period already provided before a Notice of Sale can be given in order to allow all parties to pursue a loan modification to prevent foreclosure of loans meeting certain criteria identified in that section.

A mortgage loan servicer who has implemented a comprehensive loan modification program may file an application for exemption from the provisions of Civil Code Section 2923.52. Approval of this application provides the mortgage loan servicer an exemption from the additional 90-day period before filing the Notice of Sale when foreclosing on real property covered by the new law.

It is impossible to predict what effect the enactment of certain of the above-mentioned legislation will have on the Company. Moreover, it is likely that other bills affecting the business of banks may be introduced in the future by the United States Congress or California legislature.

Employees

At December 31, 2014, the Company employed 132 persons on a full-time equivalent basis. The Company believes its employee relations are excellent.

Available Information

The Company files period reports and other reports under the Securities and Exchange Act of 1934 with the Securities and Exchange Commission (SEC). These reports, as well as the Company's Code of Ethics, are posted and are available at no cost on the Company's website at http://www.unitedsecuritybank.com as soon as reasonably practical after the Company files such reports with the SEC. The Company's periodic and other reports filed with the SEC are also available at the SEC's website (http://www.sec.gov).

Item 1B. - Unresolved Staff Comments

The Company had no unresolved staff comments at December 31, 2014.

Item 2 - Properties

The Bank's Main bank branch is located at 2151 West Shaw Avenue, Fresno, California. The Company owns the building and leases the land under a sublease dated December 1, 1986, between Central Bank and USB. The current sublessor under the master ground lease is Bank of the West, which acquired the position through the purchase of Central Bank. The lessor under the ground lease (Master Lease) is Thomas F. Hinds. The lease expires on December 31, 2015, and the Company has options to extend the term for four (4) ten-year periods and one seven (7) year period.

The Company leases the banking premises of approximately 6,450 square feet for its second of three Fresno branches at 7088 N. First St, Fresno, California., under a lease which commenced August 2005 for a term of ten years expiring in July 2015. The branch was previously located at 1041 E. Shaw Avenue, Fresno, California, under a lease extension expiring February 28, 2005. The 7088 N. First location provides space for the relocated branch as well as the Real Estate Construction Department and the Indirect Consumer Lending Department.

The Company leases the Oakhurst bank branch located at the Old Mill Village Shopping Center, 40074 Highway 49, Oakhurst, California. The branch facility consists of approximately 5,000 square feet with a lease term of 5 years ending April 2019, and has a five-year option to extend the lease term after that date.

The Company owns the Caruthers bank branch located at 13356 South Henderson, Caruthers, California, which consists of approximately 5,000 square feet of floor space.

The Company owns the San Joaquin branch facilities located at 21574 Manning Avenue, San Joaquin, California. The bank branch is approximately 2,500 square feet.

The Company owns the Firebaugh bank branch located at 1067 O Street, Firebaugh, California. The premises are comprised of approximately 4,666 square feet of office space situated on land totaling approximately one-third of an acre.

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The Company owns the Coalinga bank branch located at 145 East Durian, Coalinga, California. The office building has a total of 6,184 square feet of interior floor space situated on approximately 0.45 acres of land.

The Company leases the Convention Center branch located at 855 “M” Street, Suite 130, Fresno, California. Total space leased is approximately 4,520 square feet, and was occupied during March 2004. The fifteen-year lease expires in March 2019. There are no extension provisions.

The Company owns the Taft branch office premises located at 523 Cascade Place, Taft, California. The branch facilities consist of approximately 9,200 square feet of office space.

The Company owns the branch facilities located at 3404 Coffee Road, Bakersfield, California, which has approximately 6,130 square feet of office space located on 1.15 acres.

The Company leases the Campbell branch located at 1875 S. Bascom Ave. Suite 19, Campbell, California, which has approximately 2,984 square feet. The lease commenced on January 1, 2011 and expires on December 31, 2021.

The Company owns its administrative headquarters at 2126 Inyo Street, Fresno, California and is occupied by the Company’s administrative staff. The facility consists of approximately 21,400 square feet. A portion of the premises has been subleased to a third-party under a lease term of approximately seven years.

The Company leases its financial services facility located at 9 River Park Place, Suite 420, Fresno, CA. The lease commenced on October 1, 2013 and expires on September 30, 2016.

Item 3 - Legal Proceedings

From time to time, the Company is party to claims and legal proceedings arising in the ordinary course of business. At this time, the management of the Company is not aware of any material pending litigation proceedings to which it is a party or has recently been party to, which will have a material adverse effect on the financial condition or results of operations of the Company.

Item 4 – Mine Safety Disclosures

Not applicable

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PART II

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

Trading History

The Company became a NASDAQ National Market listed company on May 31, 2001, then became a Global Select listed company during 2006, and trades under the symbol UBFO.

The Company currently has four market makers for its common stock. These include, Stone & Youngberg, LLC, Howe Barnes Hoeffer & Arnett, Sandler O'Neill & Partners, and Hill Thompson, Magid & Company. The Company is aware of two other securities dealers: Smith Barney and Dean Witter Reynolds Inc., which periodically act as brokers in the Company's stock.

On March 28, 2006, the Company announced a 2-for-1 stock split of the Company's no-par common stock payable May 1, 2006 effected in the form of a 100% stock dividend. Share information for all periods presented in this 10-K have been restated to reflect the effect of the stock split.

During the third quarter ended September 30, 2008 and the fourth quarter ended December 31, 2008, the Company declared 1% stock dividends. During each of the twenty-four consecutive quarters beginning March 31, 2009 through December 31, 2014, the Company again declared 1% stock dividends. Share information for all periods presented in this Form 10-K has been restated to reflect the effect of the 1% stock dividends.

The following table sets forth the high and low closing sales prices by quarter for the Company's common stock, for the years ended December 31, 2014 and 2013.

	Closing Prices		Volume
Quarter	High	Low	
4th Quarter 2014	$5.70	$5.28	294,300
3rd Quarter 2014	$5.94	$5.41	502,400
2nd Quarter 2014	$5.73	$5.07	491,800
1st Quarter 2014	$5.74	$4.56	423,700
4th Quarter 2013	$5.73	$4.19	322,000
3rd Quarter 2013	$4.40	$3.95	313,100
2nd Quarter 2013	$4.53	$3.96	306,600
1st Quarter 2013	$4.53	$2.50	767,000

At December 31, 2014, there were approximately 735 record holders of common stock of the Company. This does not reflect the number of persons or entities who hold their stock in nominee or street name through various brokerage firms.

Dividends

The Company's shareholders are entitled to cash dividends when and as declared by the Company's Board of Directors out of funds legally available therefore. Dividends paid to shareholders by the Company are subject to restrictions set forth in California General Corporation Law, which provides that a corporation may make a distribution to its shareholders if retained earnings immediately prior to the dividend payout are at least equal the amount of the proposed distribution. As a bank holding company without significant assets other than its equity position in the Bank, the Company's ability to pay dividends to its shareholders depends primarily upon dividends it receives from the Bank. Such dividends paid by the Bank to the Company are subject to certain limitations. See "Management's Discussion and Analysis of Financial and Results of Operations – Regulatory Matters".

The Company distributed a 1% stock dividend to shareholders on January 22, 2014, April 23, 2014, July 23, 2014, and October 22, 2014. The Company distributed a 1% stock dividend to shareholders on January 24, 2013, April 24, 2013, July 24, 2013, and October 23, 2013.

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The amount and payment of dividends by the Company to shareholders are set by the Company's Board of Directors with numerous factors involved including the Company's earnings, financial condition and the need for capital for expanded growth and general economic conditions. No assurance can be given that cash or stock dividends will be paid in the future.

Securities Authorized for Issuance under Equity Compensation Plans

The following table sets forth securities authorized for issuance under equity compensation plans as for December 31, 2014.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (column a)	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders	142,562	$ 10.04	505,066
Equity compensation plans not approved by security holders	N/A	N/A	N/A
Total	142,562	$ 10.04	505,066

A complete description of the above plans is included in Note 10 of the Company's Financial Statements, in Item 8 of this Annual Report on Form 10K, and is hereby incorporated by reference.

Purchases of Equity Securities by Affiliates and Associated Purchasers

On May 16, 2007, the Company announced another stock repurchase plan to repurchase, as conditions warrant, up to 781,384 shares of the Company's common stock on the open market or in privately negotiated transactions. The repurchase plan represents approximately 5.00% of the Company's currently outstanding common stock. The duration of the program is open-ended and the timing of purchases will depend on market conditions.

As of December 31, 2014, there were 676,503 shares available for repurchase. The Company did not repurchase any common shares during the years ended December 31, 2014 and 2013.

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

Overview

Certain matters discussed or incorporated by reference in this Annual Report on Form 10-K are forward-looking statements that are subject to risks and uncertainties that could cause actual results to differ materially from those projected in the forward-looking statements. Such risks and uncertainties include, but are not limited to, those described in Management's Discussion and Analysis of Financial Condition and Results of Operations. Such risks and uncertainties include, but are not limited to, the following factors: i) competitive pressures in the banking industry and changes in the regulatory environment; ii) exposure to changes in the interest rate environment and the resulting impact on the Company's interest rate sensitive assets and liabilities; iii) decline in the health of the economy nationally or regionally which could reduce the demand for loans or reduce the value of real estate collateral securing most of the Company's loans; iv) credit quality deterioration that could cause an increase in the for loan losses; v) Asset/Liability matching risks and liquidity risks; volatility and devaluation in the securities markets, vi) failure to comply with the regulatory agreement under which the Company is subject, vii) expected cost savings from recent acquisitions are not realized, and, viii) potential impairment of goodwill and other intangible assets.. Therefore, the information set forth therein should be carefully considered when evaluating the business prospects of the Company.

The Company

On June 12, 2001, the United Security Bank (the "Bank") became the wholly owned subsidiary of United Security Bancshares (the "Company") through a tax-free holding company reorganization, accounted for on a basis similar to the pooling of

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interest method. In the transaction, each share of Bank stock was exchanged for a share of Company stock on a one-to-one basis. No additional equity was issued as part of this transaction. In the following discussion, references to the Bank are references to United Security Bank. References to the Company are references to United Security Bancshares (including the Bank).

On June 28, 2001, United Security Bancshares Capital Trust I (the "Trust") was formed as a Delaware business trust for the sole purpose of issuing Trust Preferred securities. On July 16, 2001, the Trust completed the issuance of $15 million in Trust Preferred securities, and concurrently, the Trust used the proceeds from that offering to purchase Junior Subordinated Debentures of the Company. The Company contributed $13.7 million of the $14.5 million in net proceeds received from the Trust to the Bank to increase its regulatory capital and used the rest for the Company's business. Effective January 1, 2007, the Company adopted the fair value option for its junior subordinated debt issued by the Trust. As a result of the adoption of the accounting standards related to the fair value option, the Company recorded a fair value adjustment of $1.3 million, reflected as an adjustment to beginning retained earnings. On July 25, 2007, the Company redeemed the $15.0 million in subordinated debentures plus accrued interest of $690,000 and a 6.15% prepayment penalty totaling $922,500. Concurrently, the Trust Preferred securities issued by Capital Trust I were redeemed. The prepayment penalty of $922,500 had previously been a component of the fair value adjustment for the junior subordinated debt at the initial adoption of the fair value option.

Effective December 31, 2001, United Security Bank formed a subsidiary Real Estate Investment Trust ("REIT") through which preferred stock was offered to private investors, to raise capital for the bank in accordance with the laws and regulations in effect at the time. The principal business purpose of the REIT was to provide an efficient and economical means to raise capital. The REIT also provided state tax benefits beginning in 2002. On December 31, 2003, the California Franchise Tax Board (FTB) announced certain tax transactions related to real estate investment trusts (REITs) and regulated investment companies (RICs) will be disallowed pursuant to Senate Bill 614 and Assembly Bill 1601, which were signed into law in the 4th quarter of 2003 (For further discussion see Income Taxes section of Results of Operations contained in this Management's Discussion and Analysis of Financial Condition and Results of Operations).

Effective April 23, 2004, the Company completed a merger with Taft National Bank headquartered in Taft, California. Taft National Bank ("Taft") was merged into United Security Bank and Taft's two branches, one located Taft and the other located in Bakersfield, California, began operating as branches of United Security Bank. The merger was accounted for using the purchase method of accounting, and resulted in the purchase price being allocated to the assets acquired and liabilities assumed from Taft based on the fair value of those assets and liabilities, with resultant goodwill of $1.6 million and core deposits intangibles of $1.9 million. Goodwill is not amortized but is reviewed at least annually for impairment, while core deposit intangibles were amortized over a period of 7 years. The Company has recognized no impairment on either the goodwill or core deposit intangible related to the Taft merger. .

On February 16, 2007, the Company completed its merger of Legacy Bank, N.A. with and into United Security Bank, a wholly owned subsidiary of the Company. Legacy Bank which began operations in 2003 operated one banking office in Campbell, California serving small business and retail banking clients. With its small business and retail banking focus, Legacy Bank provides a unique opportunity for United Security Bank to serve a loyal and growing small business niche and individual client base in the San Jose area. Upon completion of the merger, Legacy Bank's branch office began operating as a branch office of United Security Bank. The merger transaction was accounted for using the purchase accounting method, and resulted in the purchase price being allocated to the assets acquired and liabilities assumed from Legacy based on the fair value of those assets and liabilities. Fair value adjustments and intangible assets totaled approximately $12.9 million, including $8.8 million in goodwill. Goodwill is not amortized but is reviewed at least annually for impairment, while core deposit intangibles are being amortized over a period of 7 years. The Company did not recognize any impairment charges related to goodwill or core deposit intangibles for the years ended December 31, 2014 and 2013.

During July 2007, the Company formed USB Capital Trust II, a wholly-owned special purpose entity, for the purpose of issuing Trust Preferred Securities. Like USB Capital Trust I formed in July 2001, USB Capital Trust II is a Variable Interest Entity (VIE) and a deconsolidated entity pursuant current accounting standards related to variable interest entities. On July 23, 2007, USB Capital Trust II issued $15 million in Trust Preferred securities. The securities have a thirty-year maturity and bear a floating rate of interest (repricing quarterly) of 1.29% over the three-month LIBOR rate. Interest is payable quarterly. Concurrent with the issuance of the Trust Preferred securities, USB Capital Trust II used the proceeds of the Trust Preferred securities offering to purchase a like amount of junior subordinated debentures of the Company. The Company is to pay interest on the junior subordinated debentures to USB Capital Trust II, which represents the sole source of dividend distributions to the holders of the Trust Preferred securities. Effective September 30, 2009 and beginning with the quarterly interest payment due October 1, 2009, the Company elected to defer interest payments on the Company's $15.0 million of junior subordinated debentures relating to its trust preferred securities. The terms of the debentures and trust indentures allow for the Company to defer interest payments for up to 20 consecutive quarters without default or penalty. During the period that the interest deferrals were elected, the Company continued to record interest expense associated with the debentures. As of June 30, 2014, the Company ended the extension period, paid all accrued and unpaid interest, and is currently making quarterly interest payments. The Company may redeem the junior subordinated debentures at anytime at par.

Regulatory Agreement with the Federal Reserve Bank of San Francisco

On March 23, 2010, United Security Bancshares (the "Company") and its wholly owned subsidiary, United Security Bank (the "Bank"), entered into a formal written agreement (the "Agreement") with the Federal Reserve Bank of San Francisco (the "Federal Reserve") as a result of a regulatory examination that was conducted by the Federal Reserve and the California Department of Financial Institutions (the "DFI") in June 2009. That examination found significant increases in nonperforming assets, both classified loans and OREO, during 2008 and 2009, and heightened concerns about the Bank's use of brokered and other wholesale funding sources to fund loan growth, which created increased risk to equity capital and potential volatility in earnings.

Under the terms of the Agreement, the Company and the Bank agreed, among other things: to maintain a sound process for determining, documenting, and recording an adequate allowance for loan and lease losses; to improve the management of the Bank's liquidity position and funds management policies; to maintain sufficient capital at the Company and Bank level; and to improve the Bank's earnings and overall condition. The Company and Bank also agreed not to increase or guarantee any debt, purchase or redeem any shares of stock, declare or pay any cash dividends, or pay interest on the Company's junior subordinated debt or trust preferred securities, without prior written approval from the Federal Reserve. The Company generates no revenue of its own and, as such, relies on dividends from the Bank to pay its operating expenses and interest payments on the Company's junior subordinated debt.

Effective November 19, 2014, the Federal Reserve terminated the Agreement with the Bank and the Company and replaced it with an informal supervisory agreement that requires, among other things, obtaining written approval from the Federal Reserve prior to the payment of dividends from the Bank to the Company or the payment of dividends by the Company or interest on the Company's junior subordinated debt. The inability of the Bank to pay cash dividends to the Company may hinder the Company's ability to meet its ongoing operating obligations.

Regulatory Order from the California Department of Business Oversight

On May 20, 2010, the DFI (now known as the Department of Business Oversight (the "DBO")) issued a formal written order (the "Order") pursuant to a consent agreement with the Bank as a result of the same June 2009 joint regulatory examination. The terms of the Order were essentially similar to the Federal Reserve's Agreement, except for a few additional requirements.

On September 24, 2013, the Bank entered into an informal Memorandum of Understanding (the "MOU") with the DBO and on October 15, 2013, the Order was terminated. The Order and the MOU require the Bank to maintain a ratio of tangible shareholder's equity to total tangible assets equal to or greater than 9.0% and also requires the DBO's approval for the Bank to pay a dividend to the Company.

Accordingly, reflecting the Company's and the Bank's improved financial condition and performance, as of November 19, 2014, the Bank and the Company have been relieved of all formal regulatory agreements. Some of the governance and procedures established by the Agreement and the Order remain in place, including submission of certain plans and reports to the Federal Reserve and DBO, the Bank's obligation to maintain a 9.0% tangible shareholder's equity ratio, and the requirement to seek approvals from the Federal Reserve and the DBO for either the Bank or the Company to pay dividends and for the Company to pay interest on its outstanding junior subordinated debt. While no assurances can be given as to future regulatory approvals, over the last three quarters the DBO and the Federal Reserve have been approving the Bank's payment of dividends to the Company to cover the Company's operating expenses and its interest payments and the Company's payment of quarterly interest on the junior subordinated debt.

The Bank is currently in full compliance with the requirements of the MOU including its deadlines.

(For more information on the Agreement see the “Regulatory Matters” section included in this Management’s Discussion and Analysis of Financial Condition and Results of Operations.)

The Bank currently has eleven banking branches, one construction lending office, and one financial services office, which provide banking and financial services in Fresno, Madera, Kern, and Santa Clara counties. As a community-oriented bank holding company, the Company continues to seek ways to better meet its customers' needs for financial services, and to expand its business opportunities in today's ever-changing financial services environment. The Company's strategy is to be a better

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low-cost provider of services to its customer base while enlarging its market area and corresponding customer base to further its ability to provide those services.

Current Trends Affecting Results of Operations and Financial Position

The Company's overall operations are impacted by a number of factors, including not only interest rates and margin spreads, which impact results of operations, but also the composition of the Company's balance sheet. One of the primary strategic goals of the Company is to maintain a mix of assets that will generate a reasonable rate of return without undue risk, and to finance those assets with a low-cost and stable source of funds. Liquidity and capital resources are considered as well in the planning process to mitigate risk and allow for growth. Net interest income increased during 2014, totaling $23,617,000 and $21,391,000 for the years ended December 31, 2014 and 2013, respectively. The increase in net interest income was primarily the result of an increase in the rates on interest-earning assets. Average interest-earning assets increased approximately $34,352,000 between 2014 and 2013. Additionally, the rate on interest earning assets increased 9bp during the two periods. The increase in average earning assets between 2014 and 2013 consisted of an increase of $19,011,000 in investment securities and an increase of $30,420,000 in loans, offset by a decrease of $15,086,000 in interest-bearing deposits held at the Federal Reserve Bank. During the last two years, the Company's cost of interest-bearing liabilities has declined significantly as market rates of interest declined, with the average cost of interest-bearing liabilities dropping from 0.47% during 2013 to 0.38% for the year ended December 31, 2014.

The following table summarizes the year-to-date averages of the components of interest-earning assets as a percentage of total interest earning assets, and the components of interest-bearing liabilities as a percentage of total interest-bearing liabilities:

	YTD Average 12/31/14		YTD Average 12/31/13	
Loans	71.78	%	70.75	%
Investment securities available for sale	8.36	%	5.45	%
Interest-bearing deposits in other banks	0.26	%	0.27	%
Interest-bearing deposits in FRB	19.60	%	23.53	%
Total earning assets	100.00	%	100.00	%
NOW accounts	17.99	%	15.56	%
Money market accounts	40.86	%	41.96	%
Savings accounts	14.99	%	12.40	%
Time deposits	23.12	%	27.00	%
Other borrowings	—	%	—	%
Subordinated debentures	3.04	%	3.08	%
Total interest-bearing liabilities	100.00	%	100.00	%

In 2014, residential real estate markets in the five-county region from Merced to Kern showed strengthening improvement over the prior years. Home prices for residential real estate markets in the five-county region saw average price increases of 10% above 2013 levels. New home sales in the five-county region, excluding Merced, were up in December at 398 units compared with 325 units in 2013. The number of All Homes sold increased in December 2014 compared with a year earlier with 2,119 new and existing units sold in December 2014, compared with 1,963 units sold in 2013.

The market for OREO properties (foreclosed properties) owned by the Bank continue to strengthen. Four of the six properties added during 2014 were sold during 2014 in addition to three older properties which also sold. However, the outstanding balance of OREO increased slightly from $13,946,000 at December 31, 2013 to $14,010,000 at December 31, 2014.

Unemployment in Fresno County was 12.5% at year-end 2013 and 11.5% at the end of 2014. California improved from 7.9% to 7.6%, while the US improved from 6.7% to 5.6% at December 31, 2014. Fresno is the largest agriculture-producing county in the US and Ag production totaled $7.2 billion in 2014, a 4.3% increase over the prior year. Of the five county region, Merced to Kern, four are in the top five counties in the US for Agricultural production. The Agricultural markets in this region strengthened in 2014 fueled in part by global demand for exports that drove agricultural product prices and demand for local agricultural land higher. The agriculture affect benefits the five-county economies.

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Kern County varies slightly from Fresno County. Kern performed slightly better in unemployment at 9.9% for 2014, down from 10.7% for 2013.

Santa Clara County exhibited consistent job and income growth in 2014 based on the strength of its high-tech manufacturing sector that has benefited from increasing business investment. Unemployment rates were 4.6% at December 31, 2014, down from 5.7% in 2013.

During the year ended December 31, 2014, the Company experienced increases in real estate mortgage loans and real estate construction development loans and decreases in commercial and industrial loans, compared to the same period ended December 31, 2013. Loans increased $62,602,000 between December 31, 2013 and December 31, 2014. Commercial and industrial loans decreased $8,317,000 between December 31, 2013 and December 31, 2014. Real estate mortgage loans increased $17,512,000 between December 31, 2013 and December 31, 2014. Agricultural loans increased $781,000 between December 31, 2013 and December 31, 2014. Commercial real estate loans (a component of real estate mortgage loans) have remained as a significant percentage of total loans over the past year, amounting to 33.78% and 36.41%, of the total loan portfolio at December 31, 2014 and December 31, 2013, respectively. Commercial real estate loans increased $10,753,000 during 2014. Residential mortgage loans are not generally a large part of the Company's loan portfolio, but some residential mortgage loans have been made over the past several years to facilitate take-out loans for construction borrowers when they were not able to obtain permanent financing elsewhere and through purchases of residential mortgage pools. These loans are generally 30-year amortizing loans with maturities of between three and five years. Residential mortgages totaled $59,095,000 or 12.91% of the portfolio at December 31, 2014, $52,036,000, or 13.16% of the portfolio at December 31, 2013. Loan participations purchased totaled $30,000 or 0.01% of the portfolio at December 31, 2013. The bank held no loan participations at December 31, 2014. Loan participations sold decreased from $9,786,000 or 2.5% of the portfolio at December 31, 2013, to $6,230,000, or 1.4%, at December 31, 2014.

Although market rates of interest are at historically low levels, the Company's disciplined deposit pricing efforts have helped maintain adequate margins. The Company's net interest margin increased to 4.01% for the year ended December 31, 2014, when compared to 3.86% for the year ended December 31, 2013. The net interest margin has improved due to growth of the loan portfolio, which is a higher yielding asset, compared to overnight investments with the Federal Reserve Bank. The Company has successfully sought to mitigate the low-interest rate environment with loan floors included in new and renewed loans when practical. Loans yielded 5.62% during the year ended December 31, 2014, as compared to 5.60% for the year ended December 31, 2013. The decrease in the Company's cost of funds over the past year has also contributed to the improved net interest margin. The Company's average cost of funds was 0.38% for the year ended December 31, 2014, as compared to 0.47% for the year ended December 31, 2013. The Company does not intend to increase its current level of brokered deposits, the level of brokered deposits is expected to remain level at least in the short-term. Currently CDARs reciprocal deposits are the only brokered deposits in the Company. The CDARs reciprocal deposit is preferred by some depositors.

Total noninterest income of $5,161,000 reported for the year ended December 31, 2014 increased $1,193,000 or 30.07% as compared to the year ended December 31, 2013. Noninterest income continues to be driven by customer service fees, which totaled $3,473,000 for the year ended December 31, 2014. However, the increase in noninterest income between the years ended December 31, 2014 and December 31, 2013, was primarily the result of a $691,000 increase in gain on sale of other investments.

Noninterest expense increased approximately $132,000 or 0.69% between the years ended December 31, 2013 and December 31, 2014. The increases experienced during the year ended December 31, 2014, were primarily the result of an increase of $300,000 in the net operating cost on OREO and $181,000 in professional fees, partially offset by decreases in amortization expenses and regulatory insurance assessments.

On March 25, 2014, June 24, 2014, September 23, 2014, and December 16, 2014, the Company's Board of Directors declared a one-percent (1%) quarterly stock dividend on the Company's outstanding common stock. The Company believes, given the current uncertainties in the economy and unprecedented declines in real estate valuations in our markets, it is prudent to retain capital in this environment, and better position the Company for future growth opportunities. Based upon the number of outstanding common shares on the record date of April 11, 2014, July 11 2014, October 10, 2014, and January 9, 2015, respectively, an additional 147,971, 149,448, 151,178, and 152,704 shares, respectively, were issued to shareholders. For purposes of earnings per share calculations, the Company's weighted average shares outstanding and potentially dilutive shares used in the computation of earnings per share have been restated after giving retroactive effect to the 1% stock dividends to shareholders for all periods presented.

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The Company has sought to maintain a strong, yet conservative balance sheet while continuing to reduce the level of nonperforming assets and maintain adequate liquidity during the year ended December 31, 2014. Total assets increased approximately $27,240,000 during the year ended December 31, 2014, including an increase of $64,000 in OREO, an increase of $62,799,000 in net loans and an increase of $4,685,000 in investment securities, partially offset by a decrease of $31,635,000 in cash and cash equivalents. Total deposits increased $22,884,000, including an increase of $1,122,000 in noninterest-bearing deposits, an increase of $27,103,000 in savings, NOW and money market accounts, and a decrease of $5,341,000 in time deposits during the year ended December 31, 2014. Average loans comprised approximately 71.79% and 70.75% of overall average earning assets during the years ended December 31, 2014 and December 31, 2013, respectively.

Nonperforming assets, which are primarily related to the real estate loan and other real estate owned portfolio, remained high during the year ended December 31, 2014, but decreased $2,462,000 from a balance of $32,048,000 at December 31, 2013 to a balance of $29,586,000 at December 31, 2014. Nonaccrual loans totaling $9,935,000 at December 31, 2014, decreased $2,406,000 from the balance of $12,341,000 reported at December 31, 2013. In determining the adequacy of the underlying collateral related to these loans, management monitors trends within specific geographical areas, loan-to-value ratios, appraisals, and other credit issues related to the specific loans. Impaired loans decreased $2,095,000 during the year ended December 31, 2014 to a balance of $16,037,000 at December 31, 2014. Other real estate owned through foreclosure increased $64,000 between December 31, 2013 and December 31, 2014. As a result of the related events, nonperforming assets as a percentage of total assets decreased from 5.04% at December 31, 2013 to 4.46% at December 31, 2014.

The following table summarizes various nonperforming components of the loan portfolio, the related allowance for loan and lease losses and provision for credit losses for the periods shown.

(In thousands)	December 31, 2014		December 31, 2013		December 31, 2012	
Provision for credit losses during period	$(845	)	$(1,098	)	$1,019	
Allowance as % of nonperforming loans	69.15	%	60.70	%	50.92	%
Nonperforming loans as % total loans	3.40	%	4.58	%	5.78	%
Restructured loans as % total loans	3.28	%	2.29	%	4.19	%

When the economy declined along with asset valuations, increased emphasis was placed on impairment analysis of both tangible and intangible assets on the balance sheet. As of March 31, 2014, the Company conducted annual impairment testing on the largest component of its outstanding balance of goodwill, that of the Campbell operating unit (resulting from the Legacy merger during February 2007.) The Company completed a "Step 0" analysis for the Campbell reporting unit as of March 31, 2014, and a "Step 1" at March 31, 2013, and concluded that there was no impairment of the goodwill related to the Campbell operating unit for the years ended December 31, 2014 and 2013.

Management continues to monitor economic conditions in the real estate market for signs of further deterioration or improvement which may impact the level of the allowance for loan losses required to cover identified losses in the loan
portfolio. Greater focus has been placed on monitoring and reducing the level of problem assets, including working with borrowers to identify options, including loan restructures, to work through these difficult economic times. As a result of these efforts, the number of restructured loans increased from 41 loans totaling $19,275,000 at December 31, 2011, to approximately 58 loans totaling $16,773,000 at December 31, 2012, decreasing to 35 loans totaling $9,059,000 at December 31, 2013, and decreasing to 33 loans totaling $15,000,000 at December 31, 2014. A negative provision was made to the allowance for credit losses totaling $845,000 during the year ended December 31, 2014, as compared to a negative provision of $1,098,000 for the year ended December 31, 2013. Negative provisions made to the allowance for credit losses, totaling $750,000 made during the fourth quarter of 2014, provided a level in the allowance for credit losses that is deemed adequate to cover inherent losses in the loan portfolio. Net loan and lease recoveries during the year ended December 31, 2014 totaled $629,000, as compared to $302,000 in net recoveries for the year ended December 31, 2013. The Company charged-off approximately 13 loans during the year ended

December 31, 2014, compared to 24 loans during the year ended December 31, 2013. Net loan and lease recoveries totaling $629,000 during the year ended December 31, 2014, included $143,000 in net recoveries during the quarter ended March 31, 2014, $58,000 in net recoveries during the quarter ended June 30, 2014, $28,000 in net recoveries during the quarter ended September 30, 2014, and $400,000 in net recoveries during the fourth quarter of 2014. The percentage of net recoveries to average loans was 0.15%, for the year ended December 31, 2014. The percentages for the years ended December 31, 2013 and 2012 included net recoveries of 0.08% and net charge-offs of 0.74%, respectively.

Deposits increased by $22,884,000 during the year ended December 31, 2014, with increases in savings, NOW, and money market accounts and non interest bearing deposits, partially offset by decreases in time accounts. Time deposits decreased $5,341,000 during the year ended December 31, 2014, likely due to the low interest rate environment.

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Brokered deposits have provided the Company a relatively inexpensive funding source over the past several years totaling $11,480,000 or 2.03% of total deposits at December 31, 2014, as compared to $11,500,000 or 2.12% of total deposits at December 31, 2013. Brokered deposits and other wholesale funding sources were used to some degree to fund loan growth in 2007 and 2008, but the current state of the economy and the financial condition of the Company have made it increasingly important to continue to develop core deposits and reduce the Company's dependence on brokered and other wholesale funding sources, including lines of credit with the Federal Reserve Bank and the FHLB. The Company increased its efforts early in 2009 to develop core deposit growth with employee training throughout the entire organization and a deposit-gathering program that incented employees to bring in new deposits from our local market area and establish more extensive relationships with our customers. The Company continues its deposit growth program resulting in over $100,000,000 in new deposits to the bank. The Company has reduced its reliance on brokered deposits to 2.03%, a level more comparable with peers, which is currently about 2.5% of total deposits. .

The Company had no borrowings at December 31, 2014 and 2013, but the Company will maintain overnight borrowing and other term credit lines as deemed prudent.

The cost of the Company's subordinated debentures issued by USB Capital Trust II has remained low along with market rates over the last three or four years. With pricing at 3-month-LIBOR plus 129 basis points, the effective cost of the subordinated debt was 1.55% and 1.54% at December 31, 2014 and 2013, respectively. Pursuant to fair value accounting guidance, the Company has recorded $102,000 in pretax fair value losses on its junior subordinated debt during the year ended December 31, 2014, bringing the total cumulative gain recorded on the debt to $5,408,000 at December 31, 2014.

The Company continues to emphasize relationship banking and core deposit growth, focusing greatest attention on its market areas of Fresno, Madera, and Kern Counties, as well as Campbell, in Santa Clara County. The San Joaquin Valley and other California markets are exhibiting improving demand for construction lending and commercial lending from small and medium size businesses. We have seen improvement during the later part of 2012 and through 2013 and 2014, and are optimistic that these positive trends will continue. There are continued challenges for the banking industry with tight credit markets and relatively weak real estate markets adversely affecting the Banking industry and the Company.

The Company continually evaluates its strategic business plan as economic and market factors change in its market area. Balance sheet management, enhancing revenue sources, and maintaining market share will continue to be of primary importance during 2015 and beyond. The banking industry is still experiencing downward pressure on net margins as interest rates remain at historical lows. As a result, market rates of interest and asset quality will continue be important factors in the Company's ongoing strategic planning process.

Application of Critical Accounting Policies and Estimates

The Company's consolidated financial statements are prepared in accordance with generally accepted accounting principles and follow general practices within the banking industry. Application of these principles requires management to make estimates, assumptions, and judgments that affect the amounts reported in the financial statements and accompanying notes. These estimates, assumptions, and judgments are based on information available as of the date of the financial statements; accordingly, as this information changes, the financial statements could reflect different estimates, assumptions, and judgments. Certain policies inherently have a greater reliance on the use of estimates, assumptions, and judgments and as such have a greater possibility of producing results that could be materially different than originally reported. Estimates, assumptions, and judgments are necessary when assets and liabilities are required to be recorded at fair value, when a decline in the value of an asset not carried on the financial statements at fair value warrants an impairment write-down or valuation reserve to be established, or when an asset or liability needs to be recorded contingent upon a future event. Carrying assets and liabilities at fair value inherently may result in more financial statement volatility. The fair values and the information used to record valuation adjustments for certain assets and liabilities are based either on quoted market prices or are provided by other third-party sources, when available. When third-party information is not available, valuation adjustments are estimated using the Company’s own assumptions in regard to the assumptions that market participants would use in pricing the asset or liability.

The most significant accounting policies followed by the Company are presented in Note 1 to the Company’s consolidated financial statements included herein. These policies, along with the disclosures presented in the other financial statement notes and in this financial review, provide information on how significant assets and liabilities are valued in the financial statements and how those values are determined. Based on the valuation techniques used and the sensitivity of financial statement amounts to the methods, assumptions, and estimates underlying those amounts, management has identified the determination of the allowance for credit losses, other real estate owned through foreclosure, impairment of collateralized mortgage obligations and other investment securities, and fair value estimates on junior subordinated debt, valuation for deferred income taxes, and

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goodwill, to be accounting areas that require the most subjective or complex judgments, and as such could be most subject to revision as new information becomes available.

Allowance for Credit Losses

The allowance for credit losses represents management's estimate of probable credit losses inherent in the loan portfolio. Determining the amount of the allowance for credit losses is considered a critical accounting estimate because it requires significant judgment and the use of estimates related to the amount and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience, and consideration of current economic trends and conditions, all of which may be susceptible to significant change. The loan portfolio also represents the largest asset type on the consolidated balance sheet. Note 1 to the consolidated financial statements describes the methodology used to determine the allowance for credit losses and a discussion of the factors driving changes in the amount of the allowance for credit losses is included in the Asset Quality and Allowance for Credit Losses section of this financial review.

Other Real Estate Owned

Real estate properties acquired through, or in lieu of, loan foreclosure are to be sold and are initially recorded at fair value of the property, less estimated costs to sell. The excess, if any, of the loan amount over the fair value of the collateral is charged to the allowance for credit losses. The determination of fair value is generally based upon pre-approved, external appraisals. Subsequent declines in the fair value of other real estate owned, along with related revenue and expenses from operations, are charged to noninterest expense. The fair market valuation of such properties is based upon estimates, and as such, is subject to change as circumstances in the Company’s market area, or general economic trends, change.

Fair Value

Effective January 1, 2007, the Company adopted fair value option accounting standards choosing to apply the standards to its junior subordinated debt. The Company concurrently adopted the accounting standards related to fair value measurements. The accounting standards related to fair value measurements defines how applicable assets and liabilities are to be valued, and requires expanded disclosures about financial instruments carried at fair value. The fair value measurement accounting standard establishes a hierarchical disclosure framework associated with the level of pricing observability utilized in measuring financial instruments at fair value. The degree of judgment utilized in measuring the fair value of financial instruments generally correlates to the level of pricing observability. Financial instruments with readily available active quoted prices or for which fair value can be measured from actively quoted prices generally will have a higher degree of pricing observability and a lesser degree of judgment utilized in measuring fair value. Conversely, financial instruments infrequently traded or not quoted in an active market will generally have little or no pricing observability and a higher degree of judgment utilized in measuring fair value. Pricing observability is impacted by a number of factors, including the type of financial instrument, whether the financial instrument is new to the market and not yet established and the characteristics specific to the transaction. Determining fair values under the accounting standards may include judgments related to measurement factors that may vary from actual transactions executed in the marketplace. For the years ended December 31, 2014 and 2013, the Company recorded fair value adjustments related to its junior subordinated debt totaling losses of $102,000 and $776,000, respectively. (See Notes 8 and 13 of the Notes to Consolidated Financial Statements for additional information about financial instruments carried at fair value.)

Income Taxes

Deferred income taxes are provided for the temporary differences between the financial reporting basis and the tax basis of the Company's assets and liabilities. Deferred taxes are measured using current tax rates applied to such taxable income in the years in which those temporary differences are expected to be recovered. If the Company’s future income is not sufficient to apply the deferred tax assets within the tax years to which they may be applied, the deferred tax asset may not be realized and the Company’s income will be reduced. The Company recorded no valuation allowance against its deferred tax assets at December 31, 2014 and 2013.

On January 1, 2007, the Company adopted accounting standards related to uncertainty in income taxes. The standard prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Under the accounting standards, an entity should recognize the financial statement benefit of a tax position if it determines that it is more likely than not that the position will be sustained on examination. The term “more likely than not” means a likelihood of more than 50 percent. In assessing whether the more-likely-than-not criterion is met, the entity should assume that the tax position will be reviewed by the applicable taxing authority.

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Pursuant to the accounting standards related to uncertainty in income taxes, the Company will continue to re-evaluate existing tax positions, as well as new positions as they arise. If the Company determines in the future that its tax positions are not “more likely than not” to be sustained (as defined) by taxing authorities, the Company may need to recognize additional tax liabilities.

Revenue recognition

The Company’s primary sources of revenue are interest income from loans and investment securities. Interest income is generally recorded on an accrual basis, unless the collection of such income is not reasonably assured or cannot be reasonably estimated. Pursuant to accounting standards related to revenue recognition, nonrefundable fees and costs associated with originating or acquiring loans are recognized as a yield adjustment to the related loans by amortizing them into income over the term of the loan using a method which approximates the interest method. Other credit-related fees, such as standby letter of credit fees, loan placement fees and annual credit card fees are recognized as noninterest income during the period the related service is performed.

For loans placed on nonaccrual status, the accrued and unpaid interest receivable may be reversed at management's discretion based upon management's assessment of collectibility, and interest is thereafter credited to principal to the extent necessary to eliminate doubt as to the collectibility of the net carrying amount of the loan.

Results of Operations

On a year-to-date basis, the Company reported net income of $6,216,000 or $0.40 per share ($0.40 diluted) for the year ended December 31, 2014, as compared to $7,269,000 or $0.49 per share ($0.49 diluted) for the same period in 2013. The decrease of $1,053,000 between December 31, 2013 and December 31, 2014 primarily resulted from the $2.6 million reversal of the allowance for deferred tax assets in 2013. Interest income increased by $1,960,000 between December 31, 2013 and December 31, 2014 and non-interest income increased by $1,193,000.

The Company’s return on average assets was 0.93% for the year ended December 31, 2014, as compared to 1.13% for the year ended December 31, 2013. The Company’s return on average equity was 7.80% for the year ended December 31, 2014, as compared to 10.09% for the year ended December 31, 2013.

As with variances in net income, changes in the return on average assets and average equity experienced by the Company during 2014 and 2013 were effected by fluctuations in negative loan loss provisions during the past two years, as well as the reversal of the allowance for deferred tax assets and OREO-related expenses.

The following table sets forth certain selected financial data for the Bank for each of the years in the five-year periods ended December 31, 2014, and should be read in conjunction with the more detailed information and financial statements contained elsewhere herein (in thousands except per share data and ratios).

(In thousands except per share data and ratios)	2014		2013		2012		2011		2010	
Selected Financial Ratios:										
Return on average assets	0.93	%	1.13	%	0.97	%	(1.64	)%	(0.63	)%
Return on average shareholders' equity	7.80	%	10.09	%	9.23	%	(15.86	)%	(5.67	)%
Average shareholders' equity to average assets	11.88	%	11.20	%	10.55	%	10.36	%	11.06	%
Dividend payout ratio	—	%	—	%	—	%	—	%	—	%

Net Interest Income

Net interest income, the most significant component of earnings, is the difference between the interest and fees received on earning assets and the interest paid on interest-bearing liabilities. Earning assets consist primarily of loans, and to a lesser extent, investments in securities issued by federal, state and local authorities, and corporations, as well as interest-bearing deposits and overnight fed funds loaned to other financial institutions. These earning assets are funded by a combination of interest-bearing and noninterest-bearing liabilities, primarily customer deposits and may include short-term and long-term borrowings.

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Net interest income before provision for credit losses totaled $23,617,000 for the year ended December 31, 2014, representing an increase of $2,226,000, or 10.41%, when compared to the $21,391,000 reported for the same period of the previous year. The Company's year-to-date net interest margin, as shown in Table 1, increased to 4.01% at December 31, 2014 from 3.86% at December 31, 2013, an increase of 15 basis points (100 basis points = 1%) between the two periods.

Table 1. – Distribution of Average Assets, Liabilities and Shareholders' Equity:
Interest rates and interest differentials
Years ended December 31, 2014 and 2013

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(Dollars in thousands)	2014 Average Balance	2014 Interest	2014 Yield/Rate	2013 Average Balance	2013 Interest	2013 Yield/Rate
Assets:						
Interest-earning assets:						
Loans and leases (1)	$422,760	$23,777	5.62 %	$392,340	$21,979	5.60 %
Investment Securities – taxable	49,219	901	1.83 %	30,208	703	2.33 %
Interest-bearing deposits in other banks	1,518	7	0.46 %	1,511	8	0.53 %
Interest-bearing deposits in FRB	115,395	277	0.24 %	130,481	312	0.24 %
Total interest-earning assets	588,892	$24,962	4.24 %	554,540	$23,002	4.15 %
Allowance for credit losses	(11,118)			(11,299)		
Noninterest-earning assets:						
Cash and due from banks	20,447			22,417		
Premises and equipment, net	11,936			12,082		
Accrued interest receivable	1,434			1,278		
Other real estate owned	14,188			18,932		
Other assets	45,254			45,431		
Total average assets	$671,033			$643,381		
Liabilities and Shareholders' Equity:						
Interest-bearing liabilities:						
NOW accounts	$63,251	$77	0.12 %	$53,731	$60	0.11 %
Money market accounts	143,627	504	0.35 %	144,920	615	0.42 %
Savings accounts	52,681	130	0.25 %	42,837	84	0.20 %
Time deposits	81,271	393	0.48 %	93,236	571	0.61 %
Other borrowings	—	—	0.00 %	—	—	0.00 %
Junior subordinated debentures	10,681	241	2.26 %	10,640	281	2.64 %
Total interest-bearing liabilities	351,511	$1,345	0.38 %	345,364	$1,611	0.47 %
Noninterest-bearing liabilities:						
Noninterest-bearing checking	230,876			220,003		
Accrued interest payable	76			95		
Other liabilities	8,878			5,888		
Total Liabilities	591,341			571,350		
Total shareholders' equity	79,692			72,031		
Total average liabilities and shareholders' equity	$671,033			$643,381		
Interest income as a percentage of average earning assets			4.24 %			4.15 %
Interest expense as a percentage of average earning assets			0.23 %			0.29 %
Net interest margin			4.01 %			3.86 %

(1) Loan amounts include nonaccrual loans, but the related interest income has been included only if collected for the period prior to the loan being placed on a nonaccrual basis. Loan interest income includes loan fees of approximately $419,000 and $10,000 for the years ended December 31, 2014 and 2013, respectively.

The prime rate averaged 3.25% for the years ended December 31, 2014 and 2013.

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Both the Company's net interest income and net interest margin are affected by changes in the amount and mix of interest-earning assets and interest-bearing liabilities, referred to as "volume change." Both are also affected by changes in yields on interest-earning assets and rates paid on interest-bearing liabilities, referred to as "rate change." The following table sets forth the changes in interest income and interest expense for each major category of interest-earning asset and interest-bearing liability, and the amount of change attributable to volume and rate changes for the years indicated. Changes in interest income and expense, which are not attributable specifically to either rate or volume, are allocated proportionately between the two variances based on the absolute dollar amounts of the change in each.

Table 2. Rate and Volume Analysis

	2014 compared to 2013			2013 compared to 2012		
(In thousands)	Total	Rate	Volume	Total	Rate	Volume
Increase (decrease) in interest income:						
Loans	$1,798	$87	1,711	$(1,205)	$(1,380)	175
Investment securities	198	(174)	372	(1,017)	(706)	(311)
Interest-bearing deposits in other banks	(1)	(1)	—	(15)	(14)	(1)
Interest-bearing deposits in FRB	(35)	1	(36)	88	2	86
Total interest income	1,960	(87)	2,047	(2,149)	(2,098)	(51)
Increase (decrease) in interest expense:						
Interest-bearing demand accounts	(94)	(121)	27	(168)	(262)	94
Savings accounts	46	24	22	(14)	(18)	4
Time deposits	(178)	(111)	(67)	(279)	(137)	(142)
Subordinated debentures	(40)	(41)	1	11	(23)	34
Total interest expense	(266)	(249)	(17)	(450)	(440)	(10)
Increase (decrease) in net interest income	$2,226	$162	2,064	$(1,699)	$(1,658)	(41)

For the year ended December 31, 2014, total interest income increased approximately $1,960,000 or 8.52% as compared to the year ended December 31, 2013. Earning asset volumes increased in investment securities available for sale and remained constant in interest-bearing deposits in other banks between the two periods with an increase experienced in securities, which on average increased $19,011,000 between the two periods. Interest-bearing deposits in FRB decreased by $15,086,000 on average between the two periods. The average rates on loans increased 2 basis points between the two periods, and the average rate on investment securities decreased approximately 50 basis points during the year ended December 31, 2014, as compared to the same period of 2013.

For the year ended December 31, 2014, total interest expense decreased approximately $266,000, or 16.51%, as compared to the year ended December 31, 2013. Between those two periods, average interest-bearing liabilities increased by $6,147,000, while the average rates paid on these liabilities decreased by 9 basis points.

Provision for Credit Losses

Provisions for credit losses are determined on the basis of management's periodic credit review of the loan portfolio, consideration of past loan loss experience, current and future economic conditions, and other pertinent factors. Such factors consider the allowance for credit losses to be adequate when it covers estimated losses inherent in the loan portfolio. Based on the condition of the loan portfolio, management believes the allowance is sufficient to cover risk elements in the loan portfolio.

For the year ended December 31, 2014, the negative provision to the allowance for credit losses amounted to a benefit of $845,000. The benefit for the year ended December 31, 2013 totaled $1,098,000.

After the negative provision to the allowance for credit losses during the year ended December 31, 2014, the allowance was 2.35% of net outstanding loan balances at December 31, 2014, as compared to 2.78% of net outstanding loan balances at December 31, 2013. The negative loan loss provisions recorded during 2013 and 2014 are a result of continuing improvements in the overall credit quality of the loan portfolio, overall improvements in the loss history over the last year, and improvements in property values that serve as loan collateral through December 31, 2013 and December 31, 2014.

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Noninterest Income

The following table summarizes significant components of noninterest income for the years indicated and the net changes between those years:

(In thousands)	2014	2013	Amount of Change	Percent Change
Customer service fees	$3,473	$3,456	$17	0.49 %
Increase in cash surrender value of BOLI	514	556	(42)	(7.55)%
Loss on fair value option of financial liabilities	(102)	(776)	674	(86.86)%
Gain on sale of other assets	25	0	25	100.00 %
Gain on other investments	691	0	691	100.00 %
Other	560	732	(172)	(23.50)%
Total	$5,161	$3,968	$1,193	30.07 %

Noninterest income consists primarily of fees and commissions earned on services that are provided to the Company's banking customers and, to a lesser extent, gains on sales of Company assets and other miscellaneous income.

Noninterest income for the year ended December 31, 2014 increased $1,193,0000 or 30.07% when compared to the same period of 2013. Customer service fees, the primary component of noninterest income, increased $17,000 or 0.49% between the two periods presented. The increase in noninterest income of $1,193,000 between the two periods includes a gain on sale of other investment of $691,000 realized in 2014 on the sale of a local property investment and a decrease in loss on fair value of financial liability.

Noninterest Expense

The following table sets forth the components of total noninterest expense in dollars and as a percentage of average earning assets for the years ended December 31, 2014 and 2013:

(Dollars in thousands)	2014 Amount	2014 % of Average Earning Assets	2013 Amount	2013 % of Average Earning Assets
Salaries and employee benefits	$9,653	1.64 %	$9,214	1.66 %
Occupancy expense	3,760	0.64 %	3,678	0.66 %
Data processing	134	0.02 %	185	0.03 %
Professional fees	1,456	0.25 %	1,275	0.23 %
FDIC/DFI assessments	943	0.16 %	1,150	0.21 %
Directors fees	232	0.04 %	232	0.04 %
Amortization of intangibles	62	0.01 %	187	0.03 %
Correspondent bank service charges	117	0.02 %	287	0.05 %
Loss on CA Tax Credit Partnership	39	0.01 %	253	0.05 %
OREO expense	571	0.10 %	271	0.05 %
Other	2,248	0.38 %	2,351	0.42 %
Total	$19,215	3.26 %	$19,083	3.44 %

Noninterest expense increased $132,000 between the years ended December 31, 2014 and 2013. The net increase in noninterest expense between the comparative periods is primarily the result of an increase in net cost for OREO and increase in professional fees as well as increases in salaries and employee benefits and occupancy expense, partially offset by decreases in regulatory assessments, losses on tax credit partnerships, and correspondent banks service charges.

Included in net costs on operations of OREO for the years ended December 31, 2014 and 2013, are gains on the sale of OREO totaling $115,000 and $1,346,000, respectively, and OREO operating expenses totaling $685,000 and $1,403,000, respectively.

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During the years ended December 31, 2014 and 2013, the Company recognized stock-based compensation expense of $28,000 and $29,000 (less than $0.01 per share basic and diluted), respectively. This expense is included in noninterest expense under salaries and employee benefits. If new stock options are issued, or existing options fail to vest due, for example, to forfeiture, actual stock-based compensation expense in future periods will change.

Income Taxes

The Company's income tax expense is impacted to some degree by permanent taxable differences between income reported for book purposes and income reported for tax purposes, as well as certain tax credits which are not reflected in the Company's pretax income or loss shown in the statements of operations and comprehensive income. As pretax income or loss amounts become smaller, the impact of these differences become more significant and are reflected as variances in the Company's effective tax rate for the periods presented. In general, the permanent differences and tax credits affecting tax expense have a positive impact and tend to reduce the effective tax rates shown in the Company's statements of operations and comprehensive income.

The Company reviews its current tax positions at least quarterly based accounting standards related to uncertainty in income taxes which includes the criteria that an individual tax position would have to meet for some or all of the income tax benefit to be recognized in a taxable entity's financial statements. Under the income tax guidelines, an entity should recognize the financial statement benefit of a tax position if it determines that it is more likely than not that the position will be sustained on examination. The term "more likely than not" means a likelihood of more than 50 percent." In assessing whether the more-likely-than-not criterion is met, the entity should assume that the tax position will be reviewed by the applicable taxing authority.

The Company has reviewed all of its tax positions as of December 31, 2014, and has determined that, there are no material amounts that should be recorded under the current income tax accounting guidelines.

Financial Condition

Total assets increased by $27,240,000 or 4.28% during the year to $663,169,000 at December 31, 2014, and increased 14,292,000 or 4.20% from the balance of 648,877,000 at December 31, 2012. During the year ended December 31, 2014, increases of $62,799,000 were experienced in net loans. Overnight interest-bearing deposits in the Federal Reserve Bank and federal funds sold decreased a net $32,790,000, while investment securities increased by $4,685,000 during the year ended December 31, 2014. Total deposits of $565,373,000 at December 31, 2014, increased $22,884,000 or 4.22% from the balance reported at December 31, 2013, a $2,086,000 or 4.06% increase from the balance of $563,287,000 reported at December 31, 2012.

During the year ended December 31, 2013, decreases of $4,740,000 were experienced in net loans as real estate lending plateaued and approximately $1.3 million in problem loans were transferred to OREO, while another $1,586,000 was charged off against the allowance for loan losses. Overnight interest-bearing deposits in the Federal Reserve Bank and federal funds sold, increased a net $873,000, while investment securities increased by $11,772,000 during the year ended December 31, 2013. Total deposits of $542,489,000 at December 31, 2013 decreased $20,798,000 or 3.69% from the balance reported at December 31, 2012 of $563,287,000, and decreased $14,977,000 or 2.76% from the balance of $557,466,000 reported at December 31, 2011.

Earning assets averaged approximately $588,892,000 during the year ended December 31, 2014, as compared to $554,540,000 for the year ended December 31, 2013. Average interest-bearing liabilities increased to $351,511,000 for the year ended December 31, 2014, as compared to $345,364,000 for the year ended December 31, 2013.

Loans

The Company's primary business is that of acquiring deposits and making loans, with the loan portfolio representing the largest and most important component of its earning assets. Loans totaled $457,919,000 at December 31, 2014, representing an increase of $62,602,000 or 15.84% when compared to the balance of $395,317,000 at December 31, 2013. During 2014 average loans increased 7.75% when compared to the year ended December 31, 2013. Average loans totaled $422,760,000, $392,340,000, and $389,377,000 for the years ended December 31, 2013, 2013 and 2012, respectively.

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The following table sets forth the amounts of loans outstanding by category and the category percentages as of the year-end dates indicated:

(In thousands)	2014 Dollar Amount	2014 % of Loans		2013 Dollar Amount	2013 % of Loans		2012 Dollar Amount	2012 % of Loans		2011 Dollar Amount	2011 % of Loans		2010 (1) Dollar Amount	2010 (1) % of Loans	
Commercial and Industrial	$62,369	13.6	%	70,686	17.9	%	72,117	18.0	%	99,060	24.2	%	159,224	36.0	%
Real estate mortgage	214,877	46.9	%	197,365	49.9	%	189,934	47.5	%	182,131	44.6	%	157,781	35.7	%
RE construction & development	137,158	30.0	%	87,004	22.0	%	90,941	22.7	%	70,877	17.3	%	65,182	14.8	%
Agricultural	31,713	6.9	%	30,932	7.8	%	36,169	9.0	%	45,483	11.1	%	46,308	10.5	%
Installment/other	11,802	2.6	%	9,330	2.4	%	10,884	2.7	%	11,115	2.8	%	12,891	2.9	%
Lease financing	—	—	%	—	—	%	12	0.1	%	49	—	%	305	0.1	%
Total Loans	$457,919	100.0	%	$395,317	100.0	%	$400,057	100.0	%	$408,715	100.0	%	$441,691	100.0	%

(1) See Notes to Financial Statements 1.r.

Loan volume continues to be greatest in what has historically been the Bank's primary lending emphasis: commercial, real estate mortgage, and construction lending. Total loans increased $62,602,000 during 2014. With signs of recovery in the real estate markets, the Company experienced increases of $17,512,000, or 8.9%, in real estate mortgage and increases in construction lending of $50,154,000, or 57.6%. While commercial and industrial loans decreased $8,317,000 or 11.77%, agriculture loans increased $781,000, or 2.5%, and installment loans increased $2,472,000, or 26.5% when compared to the previous year.

During 2013, the Company experienced a decrease of $3,937,000 or 4.3% in construction loans, an increase of $7,431,000 or 3.9% in real estate mortgage loans, a decrease of $5,237,000 or 14.5% in agricultural loans and a decrease of $1,554,000 or 14.3% in installment loans.

At December 31, 2014, approximately 43.3% of commercial and industrial loans have floating rates and, although some may be secured by real estate, many are secured by accounts receivable, inventory, and other business assets. Residential housing markets regained some momentum in 2014, and as a result, real estate mortgage loans increased $17,512,000 and real estate construction loans increased $50,154,000 or 57.6% during 2014, as compared to a decrease in real estate construction loans of $3,937,000 or 4.3% during 2013. Construction loans are generally short-term, floating-rate obligations, which consist of both residential and commercial projects. Agricultural loans, which primarily consist of short-term, floating rate loans for crop financing, increased $781,000 or 2.5% between December 31, 2013 and December 31, 2014; and commercial loans consisting primarily of loans for non real estate business operations, decreased $8,317,000 or 11.77%. Installment loans increased $2,472,000 or 26.5% during that same period.

The real estate mortgage loan portfolio totaling $214,877,000 at December 31, 2014, consists of commercial real estate, residential mortgages, and home equity loans. Commercial real estate is the predominate segment of the portfolio, with balances of $154,672,000, and $143,919,000 at December 31, 2014 and 2013, respectively. Commercial real estate loans are generally a mix of short to medium-term, fixed and floating rate instruments and, are mainly secured by commercial income and multi-family residential properties. The Company does not currently offer traditional residential mortgage loans, but may purchase mortgage portfolios. The residential real estate mortgage portfolio had balances of $59,095,000 and $52,036,000 at December 31, 2014 and 2013, respectively. The Company also offers short to medium-term, fixed-rate, home equity loans, which totaled $1,110,000 at December 31, 2014 and $1,410,000 at December 31, 2013.

The following table sets forth the maturities of the Bank's loan portfolio at December 31, 2014. Amounts presented are shown by maturity dates rather than repricing periods:

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(In thousands)	Due in one year or less	Due after one year through five years	Due after five years	Total
Commercial and agricultural	$31,608	$45,651	$16,823	$94,082
Real estate construction & development	72,746	64,201	211	137,158
Real estate – mortgage	27,268	111,512	76,097	214,877
All other loans	2,636	7,832	1,334	11,802
Total Loans	$134,258	$229,196	$94,465	$457,919

For the year ended December 31, 2014 and 2013, the average yield on loans was 5.62% and 5.60%, respectively. This consistent yield was due in part to the Company utilizing rate floors intended to mitigate interest rate risk if interest rates fall, as well as to compensate the Company for additional credit risk under current market conditions. The Bank's loan portfolio is generally comprised of short-term or floating rate loans and is therefore susceptible to fluctuations in market rates of interest.

At December 31, 2014 and 2013, approximately 39.9% and 40.4% of the Bank's loan portfolio consisted of floating rate instruments, with the majority of those tied to the prime rate.

The following table sets forth the contractual maturities of the Bank's fixed and floating rate loans at December 31, 2014. Amounts presented are shown by maturity dates rather than repricing periods, and do not consider renewals or prepayments of loans:

(In thousands)	Due in one year or less	Due after one Year through Five years	Due after Five years	Total
Accruing loans:				
Fixed rate loans	$36,822	$186,090	$42,832	$265,744
Floating rate loans	96,776	35,657	49,807	182,240
Total accruing loans	133,598	221,747	92,639	447,984
Nonaccrual loans:				
Fixed rate loans	648	7,450	1,404	9,502
Floating rate loans	12	—	421	433
Total nonaccrual loans	660	7,450	1,825	9,935
Total Loans	$134,258	$229,197	$94,464	$457,919

Securities

Following is a comparison of the amortized cost and approximate fair value of available-for-sale for the years indicated:

	December 31, 2014				December 31, 2013			
(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value (Carrying Amount)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value (Carrying Amount)
Available-for-sale:								
U.S. Government agencies	$12,097	$399	$—	$12,496	$14,060	$441	$—	$14,501
U.S. Government sponsored entities & agencies collateralized by	31,659	336	(13)	31,982	25,029	434	(78)	25,385

mortgage obligations												
Mutual Funds	4,000	—	(177	)	3,823	4,000	—	(270	)	3,730		
Total available-for-sale	$47,756	$735	$(190	)	$48,301	$43,089	$875	$(348	)	$43,616		

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The contractual maturities of investment securities as well as yields based on amortized cost of those securities at December 31, 2014 are shown below. Actual maturities may differ from contractual maturities because issuers have the right to call or prepay obligations with or without call or prepayment penalties.

	One year or less		After one year to five years		After five years to ten years		After ten years		Total	
(Dollars in thousands)	Amount	Yield (1)	Amount	Yield (1)	Amount	Yield (1)	Amount	Yield (1)	Amount	Yield (1)
Available-for-sale:										
U.S. Government agencies	$31	5.48 %	$—	— %	$—	— %	$12,465	2.6 %	$12,496	2.61 %
U.S. Government sponsored entities & agencies collateralized by mortgage obligations	9,026	0.61 %	7,004	2.17 %	14,867	2.16 %	1,085	5.41 %	31,982	1.84 %
Mutual Funds	3,823	2.04 %	—	— %	—	— %	—	— %	3,823	2.04 %
Total estimated fair value	$12,880	1.05 %	$7,004	2.17 %	$14,867	2.16 %	$13,550	2.83 %	$48,301	2.06 %

(1) Weighted average yields are not computed on a tax equivalent basis

At December 31, 2014 and 2013, available-for-sale securities with an amortized cost of approximately $20,865,000 and $23,935,000, respectively (fair value of $23,935,000 and $24,739,000, respectively) were pledged as collateral for public funds and FHLB borrowings.

Deposits

The Bank attracts commercial deposits primarily from local businesses and professionals, as well as retail checking accounts, savings accounts and time deposits. Total deposits increased $22,884,000 or 4.22% during the year to a balance of $565,373,000 at December 31, 2014. Core deposits, consisting of all deposits other than time deposits of $100,000 or more and brokered deposits, continue to provide the foundation for the Bank's principal sources of funding and liquidity. These core deposits amounted to 88.6% and 87.8% of the total deposit portfolio at December 31, 2014 and 2013, respectively.

The following table sets forth the year-end amounts of deposits by category for the years indicated, and the dollar change in each category during the year:

	December 31,			Change during Year	
(In thousands)	2014	2013	2012	2014	2013
Noninterest-bearing deposits	$215,439	$214,317	$217,014	$1,122	$(2,697)
Interest-bearing deposits:					
NOW and money market accounts	211,290	198,928	203,771	12,362	(4,843)
Savings accounts	60,499	45,758	43,117	14,741	2,641
Time deposits:					
Under $100,000	25,345	28,825	32,532	(3,480)	(3,707)
$100,000 and over	52,800	54,661	66,853	(1,861)	(12,192)
Total interest-bearing deposits	349,934	328,172	346,273	21,762	(18,101)
Total deposits	$565,373	$542,489	$563,287	$22,884	$(20,798)

The Company has continued to reduce its reliance on brokered and other wholesale funding sources and has systematically reduced the level of brokered deposits below peer levels (as percentage of total deposits) by allowing maturing brokered deposit run-off. As of December 31, 2014, brokered deposits totaled 2.03% of total deposits which the Company believes to be in line with peers.

During the year ended December 31, 2014, increases were experienced across all categories except for time deposits. Total time deposits decreased $5,341,000 or 1.63% during the year ended December 31, 2014, and brokered deposits, a component of total time deposits, decreased slightly by $20,000, or 2.03%, during the year. Non interest bearing deposits increased

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$1,122,000 during the year. Additionally, significant increases in savings accounts and NOW and money market accounts of $14,741,000, or 32.22%, and $12,362,000, or 6.21%, respectively, were realized during the year ended December 31, 2014.

During the year ended December 31, 2013, decreases in NOW and money market accounts of $4,843,000, or 2.4%, and decreases of $18,101,000, or 3.2%, in time deposits were experienced. Of the $18,101,000 decrease in time deposits, $6,484,000 was attributable to decreases in brokered deposits. While non-interest bearing deposits declined by $2,697,000, or 1.2%, a comparable increase of $2,641,000, or 6.1%, was realized in savings accounts.

The Company's deposit base consists of two major components represented by noninterest-bearing (demand) deposits and interest-bearing deposits. Interest-bearing deposits consist of time certificates, NOW and money market accounts and savings deposits. Significant increases in deposits were realized during 2014. Total noninterest-bearing deposits increased $1,122,000, or 0.5%, between December 31, 2013 and December 31, 2014, and total interest-bearing deposits increased $21,762,000, or 6.6%, during the same period. Between December 31, 2012 and December 31, 2013, total interest-bearing deposits decreased $18,101,000, or 3.2%, and total noninterest-bearing deposits decreased $2,697,000, or 1.2%.

On a year-to-date average basis, total deposits increased $16,979,000 or 3.1% between the years ended December 31, 2013 and December 31, 2014. Of that total, interest-bearing deposits increased by $6,106,000 or 1.8%, and noninterest-bearing deposits increased $10,873,000 or 4.94% during 2014. On average, the Company experienced decreases in time deposits, while NOW accounts, money market and savings accounts increased between the years ended December 31, 2013 and December 31, 2014. On a year-to-date average basis, total deposits increased by $12,310,000 or 2.3% between the years ended December 31, 2012 and December 31, 2013. Of that total, interest-bearing deposits increased by $2,310,000 or 0.69%, while noninterest-bearing deposits increased $10,000,000 or 4.76% during 2013. On average, the Company experienced increases in non-interest bearing accounts, NOW and money market accounts, and savings, while time deposits decreased between the years ended December 31, 2012 and December 31, 2013.

The following table sets forth the average deposits and average rates paid on those deposits for the years ended December 31, 2014, 2013, and 2012:

(Dollars in thousands)	2014 Average Balance	Rate %		2013 Average Balance	Rate %		2012 Average Balance	Rate %	
Interest-bearing deposits:									
Checking accounts	$206,878	0.28	%	$198,651	0.34	%	$177,142	0.48	%
Savings	52,681	0.25	%	42,837	0.20	%	40,986	0.24	%
Time deposits (1)	81,271	0.48	%	93,236	0.61	%	114,286	0.74	%
Noninterest-bearing deposits	230,876			220,003			210,003		

(1) Included at December 31, 2014, are $52,800,000 in time certificates of deposit of $100,000 or more, of which $12,450,000 matures in three months or less, $20,774,000 matures in 3 to 12 months, and $8,508,000 matures in more than 12 months.

Short-term Borrowings

The Company has the ability to obtain borrowed funds consisting of federal funds purchased, discount window borrowings, securities sold under agreements to repurchase ("repurchase agreements") and Federal Home Loan Bank ("FHLB") advances as alternatives to retail deposit funds. The Company has established collateralized and uncollateralized lines of credit with several correspondent banks, the FRB discount window, as well as a securities dealer, for the purpose of obtaining borrowed funds as needed. The Company may continue to borrow funds in the future as part of its asset/liability strategy, and may use these funds to acquire certain other assets as deemed appropriate by management for investment purposes and to better utilize the capital resources of the Bank. Federal funds purchased represent temporary overnight borrowings from correspondent banks and are generally unsecured. Repurchase agreements are collateralized by mortgage backed securities and securities of U.S. Government agencies, and generally have maturities of one to six months, but may have longer maturities if deemed appropriate as part of the Company’s asset/liability management strategy. FHLB advances are collateralized by the Company’s investment in FHLB stock, securities, and certain qualifying mortgage loans. In addition, the Company has the ability to obtain borrowings from the Federal Reserve Bank of San Francisco ("FRB"), collateralized by certain pledged loans in the Company’s loan portfolio. The lines of credit are subject to periodic review of the Company’s financial statements by the grantors of the credit lines. Lines of credit may be modified or revoked at any time if the grantors feel there are adverse trends in the Company’s financial position.

The Company had collateralized lines of credit with the FRB of $286,993,000 and $254,761,000, as well as FHLB lines of credit totaling $5,814,000 and $7,094,000 at December 31, 2014 and 2013, respectively. In addition, the Company obtained a $10,000,000 uncollateralized line of credit during 2013 from Pacific Coast Bankers Bank. At December 31, 2014, the Company had no outstanding balances drawn against any of its lines of credit. These lines of credit generally have interest rates tied to the Federal Funds rate or are indexed to short-term U.S. Treasury rates or LIBOR.

Asset Quality and Allowance for Credit Losses

Lending money is the Company's principal business activity, and ensuring appropriate evaluation, diversification, and control of credit risks is a primary management responsibility. Losses are implicit in lending activities and the amount of such losses will vary, depending on the risk characteristics of the loan portfolio as affected by local economic conditions and the financial experience of borrowers.

The allowance for credit losses is maintained at a level deemed appropriate by management to provide for known and inherent risks in existing loans and commitments to extend credit. The adequacy of the allowance for credit losses is based upon management's continuing assessment of various factors affecting the collectability of loans and commitments to extend credit; including current economic conditions, past credit experience, collateral, and concentrations of credit. There is no precise method of predicting specific losses or amounts which may ultimately be charged off on particular segments of the loan portfolio. The conclusion that a loan may become uncollectible, either in part or in whole is judgmental and subject to economic, environmental, and other conditions which cannot be predicted with certainty. When determining the adequacy of the allowance for credit losses, the Company follows, in accordance with GAAP, the guidelines set forth in the Revised Interagency Policy Statement on the Allowance for Loan and Lease Losses (“Statement”) issued by banking regulators in December 2006. The Statement is a revision of the previous guidance released in July 2001, and outlines characteristics that should be used in segmentation of the loan portfolio for purposes of the analysis including risk classification, past due status, type of loan, industry or collateral. It also outlines factors to consider when adjusting the loss factors for various segments of the loan portfolio, and updates previous guidance that describes the responsibilities of the board of directors, management, and bank examiners regarding the allowance for credit losses. Securities and Exchange Commission Staff Accounting Bulletin No. 102 was released during July 2001, and represents the SEC staff’s view relating to methodologies and supporting documentation for the Allowance for Loan and Lease Losses that should be observed by all public companies in complying with the federal securities laws and the Commission’s interpretations. It is also generally consistent with the guidance published by the banking regulators.

The allowance for loan losses includes an asset-specific component, as well as a general or formula-based component. The Company segments the loan and lease portfolio into eleven (11) segments, primarily by loan class and type, that have homogeneity and commonality of purpose and terms for analysis under the formula-based component of the allowance. Those loans which are determined to be impaired under current accounting guidelines are not subject to the formula-based reserve analysis, and are instead evaluated individually for specific impairment under the asset-specific component of the allowance. The eleven segments of the Company’s loan portfolio are as follows (subtotals are provided as needed to allow the reader to reconcile the amounts to the Company’s loan classification reported elsewhere in these financial statements):

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Loan Segments for Loan Loss Reserve Analysis	Loan Balances at December 31,				
(Dollars in thousands)	2014	2013	2012	2011	2010 (1)
Commercial and Business Loans	$60,422	$68,460	$69,780	$96,076	$154,624
Government Program Loans	1,947	2,226	2,337	2,984	4,600
Total Commercial and Industrial	62,369	70,686	72,117	99,060	159,224
Commercial Real Estate Term Loans	154,672	143,919	133,599	140,590	131,632
Single Family Residential Loans	59,095	52,036	55,016	39,682	23,764
Home Improvement/Home Equity Loans	1,110	1,410	1,319	1,859	2,385
Total Real Estate Mortgage	214,877	197,365	189,934	182,131	157,781
RE Construction and Development Loans	137,158	87,004	90,941	70,877	65,182
Agricultural Loans	31,713	30,932	36,169	45,483	46,308
Consumer Loans	11,802	9,330	10,639	10,907	12,462
Overdraft protection Lines	—	—	90	85	74
Overdrafts	—	—	155	124	355
Total Installment/other	11,802	9,330	10,884	11,116	12,891
Commercial Lease Financing	—	—	12	49	305
Total Loans	$457,919	$395,317	$400,057	$408,716	$441,691

(1) During 2012, the Company reviewed and revised the definition of the reporting segments within its loan portfolio to ensure proper uniformity of risk among such segments and has made specific reclassifications to the 2011 segments as reported for consistency. However, balances reported for years prior to 2011 were not subject to this reclassification and so are not comparable. None of the reclassifications had an impact on equity or net (loss) income.

The Company's methodology for assessing the adequacy of the allowance for credit losses consists of several key elements, which include:
- the formula allowance,
- specific allowances for problem graded loans identified as impaired
- and the unallocated allowance

The formula allowance is calculated by applying loss factors to outstanding loans and certain unfunded loan commitments. Loss factors are based on the Company's historical loss experience and on the internal risk grade of those loans and, may be adjusted for significant factors that, in management's judgment, affect the collectability of the portfolio as of the evaluation date. Factors that may affect collectability of the loan portfolio include:

- Levels of, and trends in delinquencies and nonaccrual loans;
- Trends in volumes and term of loans;
- Effects of any changes in lending policies and procedures including those for underwriting, collection, charge-off, and recovery;
- Experience, ability, and depth of lending management and staff;
- National and local economic trends and conditions and;
- Concentrations of credit that might affect loss experience across one or more components of the portfolio, including high-balance loan concentrations and participations.

Management determines the loss factors for problem graded loans (substandard, doubtful, and loss), special mention loans, and pass graded loans, based on a loss migration model. The migration analysis incorporates loan losses over the previous quarters as determined by management (time horizons adjusted as business cycles or environment changes) and loss factors are adjusted to recognize and quantify the loss exposure from changes in market conditions and trends in the Company's loan portfolio. For purposes of this analysis, loans are grouped by internal risk classifications, which are "pass", "special mention", "substandard", "doubtful", and "loss". Certain loans are homogeneous in nature and are therefore pooled by risk grade. These homogeneous loans include consumer installment and home equity loans. Special mention loans are currently performing but are potentially weak, as the borrower has begun to exhibit deteriorating trends, which if not corrected, could jeopardize repayment of the loan and result in further downgrade. Substandard loans have well-defined weaknesses which, if not corrected, could jeopardize the full satisfaction of the debt. A loan classified as “doubtful” has critical weaknesses that make full collection of the obligation improbable. Classified loans, as defined by the Company, include impaired loans and loans categorized as substandard,

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doubtful, and loss which are not considered impaired. At December 31, 2014, "classified" loans totaled $34,358,000 or 7.60% of gross loans as compared to $38,365,000 or 9.7% of gross loans at December 31, 2013.

Loan participations are reviewed for allowance adequacy under the same guidelines as other loans in the Company's portfolio, with an additional participation factor added, if required, for specific risks associated with participations. In general, participations are subject to certain thresholds set by the Company, and are reviewed for geographic location as well as the well-being of the underlying agent bank.

The formula allowance includes reserves for certain off-balance sheet risks including letters of credit, unfunded loan commitments, and lines of credit. Reserves for undisbursed commitments are generally formula allocations based on the Company's historical loss experience and other loss factors, rather than specific loss contingencies. At December 31, 2014 and 2013, the formula reserve allocated to undisbursed commitments totaled $294,000 and $183,000, respectively. The reserve for unfunded commitments is considered a reserve for contingent liabilities and is therefore carried as a liability on the balance sheet for all periods presented.

Specific allowances are established based on management's periodic evaluation of loss exposure inherent in impaired loans. For impaired loans, specific allowances are determined based on the net realizable value of the underlying collateral, the net present value of the anticipated cash flows, or the market value of the underlying assets. Formula allowances for classified loans, excluding impaired loans, are determined on the basis of additional risks involved with individual loans that may be in excess of risk factors associated with the loan portfolio as a whole. The specific allowance is different from the formula allowance in that the specific allowance is determined on a loan-by-loan basis based on risk factors directly related to a particular loan, as opposed to the formula allowance which is determined for a pool of loans with similar risk characteristics, based on past historical trends and other risk factors which may be relevant on an ongoing basis.

The unallocated portion of the allowance is based upon management's evaluation of various conditions that are not directly measured in the determination of the formula and specific allowances. The conditions may include, but are not limited to, general economic and business conditions affecting the key lending areas of the Company, credit quality trends, collateral values, loan volumes and concentrations, and other business conditions.

The following table summarizes the specific allowance, formula allowance, and unallocated allowance at December 31, 2014, 2013 and 2012.

(In thousands)	December 31, 2014	December 31, 2013	December 31, 2012
Specific allowance – impaired loans	715	$762	$658
Formula allowance – classified loans not impaired	2,450	3,205	2,871
Formula allowance – special mention loans	39	31	113
Total allowance for special mention and classified loans	3,204	3,998	3,642
Formula allowance for pass loans	6,739	6,595	2,719
Unallocated allowance	847	395	5,423
Total allowance	10,790	10,988	11,784
Impaired loans	16,037	18,132	21,931
Classified loans not considered impaired	18,321	20,233	13,105
Total classified loans	34,358	38,365	35,036
Special mention loans not considered impaired	1,766	1,825	2,057

After declining slightly from $400,057,000 at December 31, 2012, to $395,317,000 at December 31, 2013, the loan portfolio increased to $457,919,000 at December 31, 2014. The level of nonperforming loans have decreased during each of the last three years. Nonperforming loans decreased to $15,576,000 at December 31, 2014, from $18,102,000 at December 31, 2013, and $23,141,000 at December 31, 2012. During the same period, total classified loans decreased from $38,365,000 at December 31, 2013, to $34,358,000 at December 31, 2014.

(Dollars in thousands)	December 31, 2014	December 31, 2013	December 31, 2012
Allowance for loan losses - period end	$10,771	$10,988	$11,784
Net loans (recovered) charged off during period	(629)	(302)	2,883
LLR Provision during period	(845)	(1,098)	1,019
Loans outstanding at period-end	457,919	395,317	400,057
ALLL as % of loans at period-end	2.35%	2.78%	2.95%
Nonaccrual loans	9,935	12,341	13,425
Restructured Loans	5,641	5,761	9,716
Total nonperforming loans	15,576	18,102	23,141
ALLL as % of nonperforming loans	69.15%	60.70%	50.92%
Impaired loans	16,037	18,132	21,931
Classified loans not considered impaired	18,321	20,233	13,105
Total classified loans	$34,358	$38,365	$35,036
ALLL as % of classified loans	31.35%	28.64%	33.63%

Impaired loans decreased $2,095,000 between December 31, 2013 and December 31, 2014 and the specific allowance related to those impaired loans decreased $47,000 between December 31, 2013 and December 31, 2014. The formula allowance related to loans that are not impaired (including special mention and substandard) decreased by $747,000 between December 31, 2013 and December 31, 2014. The level of “pass” loans increased approximately $53,600,000 between December 31, 2013 and December 31, 2014, while the related formula allowance increased $144,000 during the same period. The formula allowance for “pass loans” is derived from the loan loss factors under migration analysis. Due to improvements in lending policies and loan review quality, less reserve is required for pass loans.

The Company’s methodology attempts to accurately estimate losses. The specific allowance portion of the analysis is designed to be self-correcting by taking into account the current loan loss experience based on that portion of the portfolio. By analyzing the estimated losses inherent in the loan portfolio on a quarterly basis, management is able to adjust specific and inherent loss estimates using the most recent information available. In performing the periodic migration analysis, management believes that historical loss factors used in the computation of the formula allowance need to be adjusted to reflect current changes in market conditions and trends in the Company’s loan portfolio. There are a number of other factors which are reviewed when determining adjustments in the historical loss factors. Those factors include 1) trends in delinquent and nonaccrual loans, 2) trends in loan volume and terms, 3) effects of changes in lending policies, 4) concentrations of credit, 5) competition, 6) national and local economic trends and conditions, 7) experience of lending staff, 8) loan review and Board of Directors oversight, 9) high balance loan concentrations, and 10) other business conditions.

The general reserve requirements (ASC 450-70) decreased with the continued strengthening of local, state, and national economies and their impact on our local lending base, which has resulted in a lower qualitative component for the general reserve calculation. These positive factors were partially offset by the Company including OREO financial results in loss history and extending the look back period used to capture the loss history for the quantitative portion of the ALLL. In the third quarter of 2013, the look back period was changed from 4 years to stake-in-the-ground(December 31, 2005), in an effort to include higher losses experienced during the credit crisis. Changes in the mix of historical losses in the look back period resulted in a reallocation of the general reserve component of the allowance amount within the various loan segments as compared to December 31, 2014, as loss experience by segment has fluctuated over time. The stake-in-the-ground methodology requires the Company to use December 31, 2005 as the starting point of the look back period to capture loss history. Time horizons are subject to Management's assessment of the current period, taking into consideration changes in business cycles and environment changes.

Management and the Company's lending officers evaluate the loss exposure of classified and impaired loans on a weekly/monthly basis and through discussions and officer meetings as conditions change. The Company's Loan Committee meets weekly and also serves as a forum to discuss specific problem assets that pose significant concerns to the Company, and to keep the Board of Directors informed through committee minutes. All special mention and classified loans are reported quarterly on Problem Asset Reports and Impaired Loan Reports and are reviewed by senior management. Migration analysis and impaired loan analysis are performed on a quarterly basis and adjustments are made to the allowance as deemed necessary. The Board of Directors is kept abreast of any changes or trends in problem assets on a monthly basis, or more often if required.

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The specific allowance for impaired loans is measured based on the present value of the expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent. The amount of impaired loans is not directly comparable to the amount of nonperforming loans disclosed later in this section. The primary differences between impaired loans and nonperforming loans are: i) all loan categories are considered in determining nonperforming loans while impaired loan recognition is limited to commercial and industrial loans, commercial and residential real estate loans, construction loans, and agricultural loans, and ii) impaired loan recognition considers not only loans 90 days or more past due, restructured loans and nonaccrual loans but may also include problem loans other than delinquent loans.

The Company considers a loan to be impaired when, based upon current information and events, it believes it is probable the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Impaired loans include nonaccrual loans, troubled debt restructures, and performing loans in which full payment of principal or interest is not expected. Management bases the measurement of these impaired loans either on the fair value of the loan's collateral or the expected cash flows on the loans discounted at the loan's stated interest rates. Cash receipts on impaired loans not performing to contractual terms and that are on nonaccrual status are used to reduce principal balances. Impairment losses are included in the allowance for credit losses through a charge to the provision, if applicable.

At December 31, 2014 and 2013, the Company's recorded investment in loans for which impairment has been recognized totaled $16,037,000 and $18,132,000, respectively. Included in total impaired loans at December 31, 2014, are $4,478,000 of impaired loans for which the related specific allowance is $715,000, as well as $11,559,000 of impaired loans that as a result of write-downs or the fair value of the collateral, did not have a specific allowance. Total impaired loans at December 31, 2013 included $5,460,000 of impaired loans for which the related specific allowance is $762,000, as well as $12,672,000 of impaired loans that as a result of write-downs or the fair value of the collateral, did not have a specific allowance. The average recorded investment in impaired loans was $15,045,000 and $20,111,000 during the years ended December 31, 2014 and 2013, respectively. In most cases, the Company uses the cash basis method of income recognition for impaired loans. In the case of certain troubled debt restructuring for which the loan is performing under the current contractual terms, income is recognized under the accrual method.

The largest category of impaired loans at December 31, 2014 was real estate mortgage loans, comprising of 46.8% of total impaired loans at December 31, 2014. While impaired construction loans increased $4,582,000, and impaired commercial and industrial loans increased $744,000, impaired real estate mortgage loans decreased $8,060,000, and impaired agricultural loans decreased $13,000 during the year ended December 31, 2014. Specific collateral related to impaired loans is reviewed for current appraisal information, economic trends within geographic markets, loan-to-value ratios, and other factors that may impact the value of the loan collateral. Adjustments are made to collateral values as needed for these factors. Of total impaired loans, approximately $13,961,000, or 87.1%, are secured by real estate at December 31, 2014, as compared to $17,361,000, or 95.8%, of total impaired loans at December 31, 2013. The following table summarizes the components of impaired loans and their related specific allowance at December 31, 2014, 2013 and 2012.

(In thousands)	Balance December 31, 2014	Allowance December 31, 2014	Balance December 31, 2013	Allowance December 31, 2013	Balance December 31, 2012	Allowance December 31, 2012
Commercial and industrial	$1,421	$64	$677	$9	$1,431	$37
Real estate – mortgage	7,513	648	15,573	753	18,457	621
Real estate construction and development	6,371	—	1,789	—	1,730	—
Agricultural	32	—	45	—	192	—
Installment/other	700	3	48	—	121	—

Lease financing	—	—	—	—	—	—
Total impaired loans	$16,037	$715	$18,132	$762	$21,931	$658

Included in impaired loans are loans modified in troubled debt restructurings (TDRs), where concessions have been granted to borrowers experiencing financial difficulties in an attempt to enhance collection. The Company makes various types of concessions when structuring TDRs including rate reductions, payment extensions, and forbearance.

At December 31, 2014, residential mortgages comprised $4,225,000 of the $15,000,000 in TDRs and commercial real estate loans comprised $6,029,000 of total TDRs.

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Total TDRs increase by 65.58% at December 31, 2014, as compared to December 31, 2013. The substantial increase in TDRs for the year ended December 31, 2014 is due to the identification of loans restructured during 2013 and 2014 had not been previously identified as TDRs. Nonaccrual TDRs increase by 183.78% and Accruing TDRs declined by 2.08% over the same period. Within TDR categories total residential mortgage and construction TDRs showed an increase of 56.38%. The majority of these credits are related to real estate construction projects that slowed significantly or stalled in 2011 and 2012, leading the Company to pursue restructuring of the qualified credits allowing the construction industry time to recover and developers opportunity to finish projects at a slower pace. Concessions granted in these circumstances include lengthened maturities, lower lot release prices, and/or rate reductions that enabled the borrower to finish the construction projects and may be entirely successful. In large part, current successes are related to a recovering real estate market that began in late 2011 and is continuing into 2015.

The following tables summarizes TDRs by type, classified separately as nonaccrual or accrual, which are included in impaired loans at December 31, 2014 and December 31, 2013.

	Total TDRs	Nonaccrual TDRs	Accruing TDRs
(In thousands)	December 31, 2014	December 31, 2014	December 31, 2014
Commercial and industrial	$1,306	$421	$885
Real estate - mortgage:			
Commercial real estate	2,713	2,713	—
Residential mortgages	4,225	1,084	3,141
Home equity loans	—	—	—
Total real estate mortgage	6,938	3,797	3,141
RE construction & development	6,029	5,141	888
Agricultural	32	—	32
Installment/other	695	—	695
Lease financing	—	—	—
Total Troubled Debt Restructurings	$15,000	$9,359	$5,641

	Total TDRs	Nonaccrual TDRs	Accruing TDRs
(In thousands)	December 31, 2013	December 31, 2013	December 31, 2013
Commercial and industrial	$675	$—	$675
Real estate - mortgage:			
Commercial real estate	1,468	1,468	—
Residential mortgages	5,273	1,583	3,690
Home equity loans	—	—	—
Total real estate mortgage	6,741	3,051	3,690
RE construction & development	1,551	247	1,304
Agricultural	44	—	44
Installment/other	48	—	48
Lease financing	—	—	—
Total Troubled Debt Restructurings	$9,059	$3,298	$5,761

Of the $15,000,000 in total TDRs at December 31, 2014, $9,359,000 were on nonaccrual status at period-end. Of the $9,059,000 in total TDRs at December 31, 2013, $3,298,000 were on nonaccrual status at period-end. As of December 31, 2014, the Company has no commercial real estate (CRE) workouts whereby an existing loan was restructured into multiple new loans (i.e., A Note/B Note structure).

A restructured loan returns to accrual status after at least 6 months of timely payment history. In addition, our Credit Administration performs a financial analysis of the credit to determine whether the borrower has the ability to continue to

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perform successfully over the remaining life of the loan. This includes, but is not limited to, review of financial statements and cash flow analysis of the borrower. Only after determination that borrowers have the ability to perform under the terms of the loans, are restructured credits considered for accrual status.

The following table summarizes special mention loans by type for the years ended December 31, 2014 and December 31, 2013.

(In thousands)	December 31, 2014	December 31, 2013
Commercial and industrial	$342	$590
Real estate - mortgage:		
Commercial real estate	1,095	—
Residential mortgages	216	1,204
Home equity loans	—	32
Total real estate mortgage	1,311	1,236
RE construction & development	—	—
Agricultural	113	—
Installment/other	—	—
Lease financing	—	—
Total Special Mention Loans	$1,766	$1,826

The Company focuses on competition and other economic conditions within its market area and other geographical areas in which it does business, which may ultimately affect the risk assessment of the portfolio. The Company continues to experience increased competition from major banks, local independents and non-bank institutions affects loan pricing. Low interest rates and a weaker economy continue to dominate, even though real estate prices show signs of stabilization. The Company continues to place increased emphasis on reducing both the level of nonperforming assets and the level of losses on the disposition of these assets. It is in the best interest of both the Company and the borrowers to seek alternative options to foreclosure in an effort to reduce the impacts on the real estate market. As part of this strategy, the Company has agreed to increasing its level of troubled debt restructurings, when doing so makes economic sense. While business and consumer spending show improvement in recent quarters, current GDP remains anemic. It is difficult to forecast what impact the Federal Reserve actions to hold rates low will have on the economy. The local market has remained relatively stable economically during the past several years than some areas of the state and the nation, where more volatile economic impacts were experienced, including more severe deterioration of residential real estate markets. Although the local area residential housing markets have been hard hit, they continue to perform better than some parts of the state which bodes well for sustained, but slower growth in the Company’s market areas of Fresno and Madera, Kern, and Santa Clara Counties. Local unemployment rates in the San Joaquin Valley remain elevated compared with other regions but historically are higher as a result of the area's agricultural dynamics. The Company believes that the Central San Joaquin Valley will continue to grow and diversify as property and housing costs remain low relative to other areas of the state. Management recognizes increased risk of loss due to the Company's exposure to local and worldwide economic conditions, as well as potentially volatile real estate markets, and takes these factors into consideration when analyzing the adequacy of the allowance for credit losses.

The following table provides a summary of the Company's allowance for credit losses, provisions made to that allowance, and charge-off and recovery activity affecting the allowance for the years indicated.

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(Dollars in thousands)	December 31, 2014	2013	2012	2011	2010
Total loans outstanding at end of period before deducting allowances for credit losses	$457,595	$395,013	$400,033	$408,715	$441,691
Average net loans outstanding during period	422,760	392,340	398,377	424,961	490,421
Balance of allowance at beginning of period	10,988	11,784	13,648	16,520	15,016
Loans charged off:					
Real estate	(200)	(635)	(630)	(7,224)	(8,119)
Commercial, Industrial & Agricultural	(318)	(678)	(3,397)	(9,340)	(2,878)
Commercial lease financing	—	—	—	(110)	(81)
Installment and other	(16)	(273)	(251)	(620)	(858)
Total loans charged off	(534)	(1,586)	(4,278)	(17,294)	(11,936)
Recoveries of loans previously charged off:					
Real estate	728	1,538	698	159	10
Commercial and industrial & agricultural	330	279	648	650	940
Installment and other	104	71	49	11	15
Total loan recoveries	1,162	1,888	1,395	820	965
Net loans (charged off) recovered	628	302	(2,883)	(16,474)	(10,971)
Provision charged to operating expense	(845)	(1,098)	1,019	13,602	12,475
Balance of allowance for credit losses at end of period	$10,771	$10,988	$11,784	$13,648	$16,520
Net loan (recoveries) charge-offs to total average loans	(0.15)%	(0.08)%	0.74%	3.88%	2.24%
Net loan (recoveries) charge-offs to loans at end of period	(0.14)%	(0.08)%	0.72%	4.03%	2.48%
Allowance for credit losses to total loans at end of period	2.35%	2.78%	2.95%	3.34%	3.74%
Net loan (recoveries) charge-offs to allowance for credit losses	(5.84)%	(2.75)%	24.47%	120.71%	66.41%
Net loan charge-offs to provision for credit losses	(134.55)%	27.50%	282.92%	121.11%	87.94%

Loan charge-offs decreased $1,052,000 during the year ended December 31, 2014, when compared to the year ended December 31, 2013. Loan recoveries decreased $726,000 during the same period. Net loan recoveries totaled $401,000 during the fourth quarter, consisting of multiple relationships.

Loan charge-offs totaled $1,586,000 during the year ended December 31, 2013. Net loan recoveries totaled $1,888,000 during 2013. Net loan recoveries totaled $414,000 during the fourth quarter of 2013, consisting of multiple relationships.

The following is a summary of the quarterly activity in the allowance for loan losses for the year ended December 31, 2014 (in thousands).

Description	Loss	Recoveries	Provision	Balance
Balance Forward				10,988
1st quarter - 2014	140	283	(47)	11,084

2nd quarter - 2014	146	203	(93)	11,048
3rd quarter - 2014	98	125	40	11,115
4th quarter - 2014	150	551	(745)	10,771
Total YTD - 2014	$534	$1,162	$(845)	$10,771

At December 31, 2014 and 2013, $294,000 and $183,000, respectively, of the formula allowance is allocated to unfunded loan commitments and is, therefore, carried separately in other liabilities.

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Management believes that the 2.35% credit loss allowance to total loans at December 31, 2014 is adequate to absorb known and inherent risks in the loan portfolio. No assurance can be given, however, that economic conditions may materialize which differ and more adversely affect the Company's service areas or other circumstances will not be reflected in increased losses in the loan portfolio. Management is not currently aware of any conditions that may adversely affect the levels of losses incurred in the Company’s loan portfolio.

Although the Company does not normally allocate the allowance for credit losses to specific loan categories, an allocation to the major categories has been made for the purposes of this report as set forth in the following table. The allocations are estimates based on the same factors as considered by management in determining the amount of additional provisions to the credit loss allowance and the overall adequacy of the allowance for credit losses.

	2014			2013			2012			2011			2010		
(Dollars in thousands)	Allowance for Credit Losses	% of Loans		Allowance for Credit Losses	% of Loans		Allowance for Credit Losses	% of Loans		Allowance for Credit Losses	% of Loans		Allowance for Credit Losses	% of Loans	
Commercial and industrial	$1,218	13.62	%	$2,340	18.0	%	$1,614	18.0	%	$4,782	40.7	%	$8,209	36.0	%
Real estate – mortgage	1,653	46.92	%	1,862	47.6	%	1,292	47.6	%	2,070	35.4	%	1,620	35.7	%
RE construction and development	6,278	29.95	%	5,533	22.7	%	2,814	22.7	%	5,634	12.3	%	5,763	14.8	%
Agricultural	482	6.93	%	583	9.0	%	352	9.0	%	803	8.8	%	850	10.5	%
Installment/other	293	2.58	%	275	2.7	%	288	2.7	%	117	2.8	%	49	2.9	%
Lease financing	—	—	%	—	—	%	1	—	%	1	—	%	3	0.1	%
Not allocated	847	—	%	395	—	%	5,423	—	%	241	—	%	26	—	%
	$10,771	100.0	%	$10,988	100.0	%	$11,784	100.0	%	$13,648	100.0	%	$16,520	100.0	%

During 2014, reserve allocations decreased for commercial and industrial loans, real estate mortgage and agricultural loans. Increases in reserve allocation for real estate construction and development is primarily due to the growth of that loan segment.

During 2013, reserve allocations increased in all categories during the year, except for small decreases in the reserve for installment loans. Increases in reserve allocations for most categories were the result of increased loss factors, which decreased the unallocated portion of the reserve.

During 2012, reserve allocations increased in installment and unallocated by $171,000 and $5,182,000, respectively, while reserve allocation for all other categories decreased. The increase in unallocated was the result of reduced loss factors.

The following summarizes the Company’s allowance for credit losses related to the specific, formula, and unallocated reserves for the year-ends shown:

	December 31,				
(In thousands)	2014	2013	2012	2011	2010
Formula allowance	$9,228	$9,831	$5,703	$12,153	$5,168
Specific allowance	715	762	658	1,254	11,326
Unallocated allowance	847	395	5,423	241	26
Total allowance	$10,790	$10,988	$11,784	$13,648	$16,520

At December 31, 2014, the allowance for credit losses totaled $10,790,000, and consisted of $9,228,000 in formula allowance, $715,000 in specific allowance, and $847,000 in unallocated allowance. At December 31, 2014, $648,000 of the specific allowance was allocated real estate loans, $64,000 was allocated to commercial and industrial loans, and the remaining $3,000 was allocated to installment loans.

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At December 31, 2013, the allowance for credit losses totaled $10,988,000, and consisted of $9,831,000 in formula allowance, $762,000 in specific allowance, and $395,000 in unallocated allowance. At December 31, 2013, $753,000 of the specific allowance was allocated to real estate loans, and the remaining $9,000 was allocated to commercial and industrial loans.

At December 31, 2012, the allowance for credit losses totaled $11,784,000, and consisted of $5,703,000 in formula allowance, $658,000 in specific allowance, and $5,423,000 in unallocated allowance. At December 31, 2012, $621,000 of the specific allowance was allocated to real estate loans, and the remaining $38,000 was allocated to commercial and industrial loans.

The total formula allowance decreased $603,000 between 2013 and 2014 and the specific allowance decreased $66,000. The unallocated allowance rose to $847,000.

The total formula allowance increased $4,128,000 between 2012 and 2013, due to an increase in the reserve factors as the Company reviewed and updated their allowance for loan loss methodology during the year.

The total formula allowance decreased approximately $6,450,000 between 2011 and 2012, primarily due decrease in the percentage loss factors as well as the Company’s internal review of loan classification definitions as they pertain to risk .

here were no loans classified as doubtful at December 31, 2014 or December 31, 2013.

Although in some instances, the downgrading of a loan resulting from the factors used by the Company in its allowance analysis has been reflected in the formula allowance, management believes that in some instances, the impact of material events and trends not known are not reflected in the level of nonperforming loans or the internal risk grading process regarding these loans. Accordingly, the Company’s evaluation of probable losses related to these factors may be reflected in the unallocated allowance. The evaluation of the inherent losses concerning these factors involves a higher degree of uncertainty because they are not identified with specific problem credits, and therefore the Company does not allocate the unallocated allowance among segments of the portfolio. At December 31, 2014 and December 31, 2013, the Company had unallocated allowances of $847,000 and $395,000. Management’s estimates of the unallocated allowance are based upon a number of underlying factors including 1) the effect of deteriorating national and local economic trends, 2) the effects of export market conditions on certain agricultural and manufacturing borrowers, 3) the effects of abnormal weather patterns on agricultural borrowers, as well as other borrowers that may be impacted by such conditions, 4) the effect of increased competition in the Company’s market area and the resultant potential impact of more relaxed underwriting standards to borrowers with multi-bank relationships, 5) the effect of soft real estate markets, and 6) the effects of having a larger number of borrowing relationships which are close to the Company’s lending limit, which, if any one were not to perform to contractual terms, would have a material impact on the allowance.

The Company's loan portfolio has elevated concentrations in commercial real estate, commercial, and construction loans, however the portfolio percentages fall within the Company's loan policy guidelines.

It is the Company's policy to discontinue the accrual of interest income on loans for which reasonable doubt exists with respect to the timely collectibility of interest or principal due to the inability of the borrower to comply with the terms of the loan agreement. Such loans are placed on nonaccrual status whenever the payment of principal or interest is 90 days past due or earlier when the conditions warrant, and interest collected is thereafter credited to principal to the extent necessary to eliminate doubt as to the collectibility of the net carrying amount of the loan. Management may grant exceptions to this policy if the loans are well secured and in the process of collection.

The following table sets forth the Company’s nonperforming assets as of the dates indicated:

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(Dollars in thousands, except footnote)	December 31, 2014	2013	2012	2011	2010
Nonaccrual loans (1)	$9,935	$12,341	$13,425	$18,098	$34,394
Restructured loans	5,641	5,761	9,716	11,885	12,554
Total non-performing loans	15,576	18,102	23,141	29,983	46,948
Other real estate owned	14,010	13,946	23,932	27,091	35,580
Total non-performing assets	$29,586	$32,048	$47,073	$57,074	$82,528
Loans, past due 90 days or more, still accruing	—	—	—	74	547
Non-performing loans to total gross loans	3.40%	4.58%	5.78%	7.34%	10.63%
Non-performing assets to total gross loans	6.47%	8.11%	11.77%	14.96%	20.63%
Allowance for loan losses to nonperforming loans	69.15%	60.70%	50.92%	45.52%	35.19%

(1) Included in nonaccrual loans at December 31, 2014 and 2013 are restructured loans totaling $9,359,000 and $3,298,000, respectively.

Non-performing assets remain elevated at December 31, 2014, but have decreased $2,462,000 between December 31, 2013 and December 31, 2014, due to a decrease in nonaccrual loans of $2,406,000, partially offset by an increase in other real estate owned of $64,000. There were no write-downs to other real estate owned during the year ended December 31, 2014.

Non-performing assets decreased $15,025,000 between December 31, 2012 and December 31, 2013, due to decreases in restructured loans of $3,995,000, and decreases in nonaccrual loans and other real estate owned of $1,084,000 and $9,986,000, respectively. The net decrease in other real estate owned includes additions of approximately $437,000 in properties transferred from loans, write-downs of $214,000, and gross sales of more than $11,454,000 during the year ended December 31, 2013.

Non-performing assets decreased $10,001,000 between December 31, 2011 and December 31, 2012. Nonaccrual loans decreased $4,673,000 between December 31, 2011 and December 31, 2012, while restructured loans not included in the nonaccrual totals decreased $2,169,000. The net decrease of $3,159,000 in other real estate owned includes additions of approximately $2,436,000 in properties transferred from loans, write-downs of $463,000 and gross sales of more than $7,472,000 during the year ended December 31, 2012.

The following table summarizes the nonaccrual totals by loan category for the periods shown:

(In thousands)	Balance December 31, 2014	December 31, 2013	December 31, 2012	Change from December 31, 2013	December 31, 2012
Commercial and industrial	$433	$—	$1,181	$433	$(748)
Real estate - mortgage	4,361	11,873	10,259	(7,512)	(5,898)
Real estate - construction	5,141	468	1,730	4,673	3,411
Agricultural	—	—	136	—	(136)
Installment/other	—	—	119	—	(119)
Lease financing	—	—	—	—	—
Total Nonaccrual Loans	$9,935	$12,341	$13,425	$(2,406)	$(3,490)

Loans past due more than 30 days are receiving increased management attention and are monitored for increased risk. The Company continues to move past due loans to nonaccrual status in its ongoing effort to recognize loan problems at an earlier point in time when they may be dealt with more effectively. As impaired loans, nonaccrual and restructured loans are reviewed for specific reserve allocations and the allowance for credit losses is adjusted accordingly.

Except for the loans included in the above table, there were no loans at December 31, 2014, where the known credit problems of a borrower caused the Company to have serious doubts as to the ability of such borrower to comply with the present loan repayment terms and which would result in such loan being included as a nonaccrual, past due or restructured loan at some future date.

Liquidity and Asset/Liability Management

The primary function of asset/liability management is to provide adequate liquidity and maintain an appropriate balance between interest-sensitive assets and interest-sensitive liabilities.

Liquidity

Liquidity management may be described as the ability to maintain sufficient cash flows to fulfill both on- and off-balance sheet financial obligations, including loan funding commitments and customer deposit withdrawals, without straining the Company’s equity structure. To maintain an adequate liquidity position, the Company relies on, in addition to cash and cash equivalents, cash inflows from deposits and short-term borrowings, repayments of principal on loans and investments, and interest income received. The Company's principal cash outflows are for loan origination, purchases of investment securities, depositor withdrawals and payment of operating expenses. Other sources of liquidity not on the balance sheet at December 31, 2014, include unused collateralized and uncollateralized lines of credit from other banks, the Federal Home Loan Bank, Pacific Coast Banker's Bank, and from the Federal Reserve Bank totaling $302,807,000.

Cash and cash equivalents have fluctuated during the three years ended December 31, 2014, 2013, and 2012, with period-end balances as follows (from Consolidated Statements of Cash Flows – in 000’s):

	Balance
December 31, 2014	$103,577
December 31, 2013	$135,212
December 31, 2012	$141,627

Cash and cash equivalents decreased $31,635,000 during the year ended December 31, 2014, as compared to a decrease of $6,415,000 during the year ended December 31, 2013.

The Company had a net cash inflow from operations of $9,002,000 for the year ended December 31, 2014, and a positive cash inflow from operations totaling $11,903,000 for the period ended December 31, 2013. The Company experienced net cash outflows from investing activities totaling $63,616,000 and net cash inflows of $2,468,000 during the years ended December 31, 2014 and December 31, 2013. For the year ended December 31, 2014, increases in loans and purchases of investment securities outweighed proceeds from sales of OREO and principal payments on available for sale securities. For the year ended December 31, 2013, the settlement of OREO properties and loan paydowns outweighed capital and investment expenditures.

During the year ended December 31, 2014, the Company experienced net cash inflows from financing activities totaling $22,979,000, primarily as the result of increases in demand deposit and savings accounts. For the year ended December 31, 2013, the Company experienced net cash outflows of $20,786,000 from financing activities due to decreases in certificates of deposit accounts.

Liquidity risk arises from the possibility the Company may not be able to satisfy current or future financial commitments, or the Company may become unduly reliant on alternative funding sources. The Company maintains a liquidity risk management policy to address and manage this risk. The policy identifies the primary sources of liquidity, sets wholesale funding limits, establishes procedures for monitoring and measuring liquidity, and establishes minimum liquidity requirements, which comply with regulatory guidance. The liquidity position is continually monitored and reported on a monthly basis to the Board of Directors.

The policy also includes a contingency funding plan to address liquidity needs in the event of an institution-specific or a systemic financial market crisis. In addition to unused lines of credit from other banks totaling $302,807,000, the contingency plan includes identified funding sources, and steps that may be taken in the event the total liquidity ratio falls or is projected to fall below policy limits for any extended period of time. One of the primary directives of the contingency funding plan is to limit the Company's overall level of wholesale funding to no more than 40% of deposits. The current funding program uses both asset-based and liability-based principles, and identifies core deposits as the favored funding source when attainable at a reasonable cost. The policy identifies a number of funding sources or methods the Bank ALCO committee may utilize to fulfill the Company's liquidity funding requirements:

1) Local core deposits are the Company's primary funding source. The Company works to attract these deposits through service-related and competitive pricing tactics. Other liquidity funding sources are considered if local core deposits are not attractive because of maturity or pricing.

2) Unsecured Federal Funds lines with correspondent banks may be used to fund short-term peaks in loan demand or deposit run-off. Currently, unsecured borrowing lines with correspondents are limited and may not be reliable for long periods of time or in times of economic stress.

3) Other funding sources such as secured credit lines with the Federal Home Loan Bank or the Federal Reserve may be used for longer periods. The Company collateralized these available lines with a combination of investment securities and pledged loans. The Company has utilized specific loan pledging with both the FHLB and the Federal Reserve to better ensure the continued availability of those lines of credit.

4) The Company presently has a Discount Window facility available from the Federal Reserve Bank of San Francisco collateralized with loans as discussed above. At December 31, 2014, the Company had available credit of $286,993,000 from the Federal Reserve based upon the loans pledged at that date. The Federal Reserve will monitor use of the Discount Window closely given the current status of the Company and the economy as a whole. This credit facility may not be competitively priced under certain economic conditions. As such, the Company does not expect to use this facility except for short periods, but does consider this to be a key contingency funding source.

5) As long as the Bank remains “Well Capitalized” the Company may rely on brokered deposits when core deposit rates are higher in the marketplace or maturity structures are not desirable. The Company’s current policy limit for brokered deposits is 25% of total deposits. The Company may also utilize other wholesale deposit sources such as memberships that advertise the Bank’s time deposit rates to other subscribers, typically banks and credit unions. The Company’s current policy limit on other wholesale deposits is 10% of total deposits.

6) The Bank may sell whole loans or participations in loans to provide additional liquidity. During economic downturns or other crises events, these funding sources may be difficult to achieve in a short period of time or at a reasonable price. As such, this strategy is better used as a long-term asset/liability management tool to effectively balance assets and liabilities to reduce liquidity risk.

7) The Company currently has Bank Owned Life Insurance (BOLI) policies issued by highly rated insurance companies which may be sold to increase liquidity.

8) The Company owns certain real estate including its administration building and several of its branches. These may be sold and vacated or leased back from the purchaser after sale to provide additional liquidity if needed. The sales process may require substantial time to complete, and may have an adverse impact on earnings depending on market rates and other factors at the time of sale.

9) Investments near maturity may be sold to meet temporary funding needs but may need to be replaced to maintain liquidity ratios within acceptable limits. At the current time approximately half of the investment portfolio is pledged to secure public deposits and borrowing lines. The Company seeks to maintain an investment-grade securities portfolio to ensure quality collateral for pledging against borrowing lines of credit as well as to provide liquidity in times of needs.

The Company's liquid asset base which generally consists of cash and due from banks, federal funds sold, securities purchased under agreements to resell (“reverse repos”) and investment securities, are maintained at levels deemed sufficient to provide the cash necessary to fund loan growth as well as projected deposit runoff. Within this framework is the objective of maximizing the yield on earning assets. This is generally achieved by maintaining a high percentage of earning assets in loans, which historically have represented the Company's highest yielding asset. At December 31, 2014, the Bank had 69.00% of total assets in the loan portfolio and a loan to deposit ratio of 80.94%, as compared to 62.12% of total assets in the loan portfolio and a loan to deposit ratio of 72.81% at December 31, 2013. Liquid assets at December 31, 2014 include cash and cash equivalents totaling $103,577,000, as compared to $135,212,000 at December 31, 2013.

Liabilities used to fund liquidity sources include core and non-core deposits as well as short-term borrowings capability. Core deposits, which comprise approximately 88.21% of total deposits at December 31, 2014, provide a significant and stable funding source for the Company. At December 31, 2014, unused lines of credit with the Federal Home Loan Bank, Pacific Coast Banker's Bank, and the Federal Reserve Bank totaling $302,807,000 are collateralized in part by certain qualifying loans in the Company’s loan portfolio. The carrying value of loans pledged on these used and unused borrowing lines totaled $406,358,000 at December 31, 2014. For further discussion of the Company’s borrowing lines, see “Short Term Borrowings” included previously in the financial condition section of this financial review.

The liquidity of the parent company, United Security Bancshares, is primarily dependent on the payment of cash dividends by its subsidiary, United Security Bank, subject to limitations imposed by the Financial Code of the State of California. The Bank currently has limited ability to pay dividends or make capital distributions (see Dividends section included in Regulatory Matters of this Management’s Discussion). The limited ability of the Bank to pay dividends may impact the ability of the

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Company to fund its ongoing liquidity requirements including ongoing operating expenses, as well as quarterly interest payments on the Company’s junior subordinated debt (Trust Preferred Securities.) Beginning the quarter ended March 31, 2009, the Bank precluded from paying a cash dividend to the Company. To conserve cash and capital resources, the Company
elected at March 31, 2009 to defer the payment of interest on its junior subordinated debt beginning with the quarterly payment
due October 1, 2009. Since the second quarter of 2014, the Bank has received approval quarterly from the Federal Reserve Bank to upstream a dividend to the parent company for the purpose of payment of deferred interest on the Company's junior
subordinated debt and for the parent company's operating expenses. During the year ended December 31, 2014, the Bank paid $1,519,000 in cash dividends to the parent company. The Bank paid no dividends to the parent company during the years ended December 31, 2013, and 2012.

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Regulatory Matters

Regulatory Agreement with the Federal Reserve Bank of San Francisco

On March 23, 2010, United Security Bancshares (the "Company") and its wholly owned subsidiary, United Security Bank (the "Bank"), entered into a formal written agreement (the “Agreement”) with the Federal Reserve Bank of San Francisco (the “Federal Reserve”) as a result of a regulatory examination that was conducted by the Federal Reserve and the California Department of Financial Institutions (the “DFI”) in June 2009. That examination found significant increases in nonperforming assets, both classified loans and OREO, during 2008 and 2009, and heightened concerns about the Bank’s use of brokered and other wholesale funding sources to fund loan growth, which created increased risk to equity capital and potential volatility in earnings.

Under the terms of the Agreement, the Company and the Bank agreed, among other things: to maintain a sound process for determining, documenting, and recording an adequate allowance for loan and lease losses; to improve the management of the Bank's liquidity position and funds management policies; to maintain sufficient capital at the Company and Bank level; and to improve the Bank’s earnings and overall condition. The Company and Bank also agreed not to increase or guarantee any debt, purchase or redeem any shares of stock, declare or pay any cash dividends, or pay interest on the Company's junior subordinated debt or trust preferred securities, without prior written approval from the Federal Reserve. The Company generates no revenue of its own and, as such, relies on dividends from the Bank to pay its operating expenses and interest payments on the Company’s junior subordinated debt.

Effective November 19, 2014, the Federal Reserve terminated the Agreement with the Bank and the Company and replaced it with an informal supervisory agreement that requires, among other things, obtaining written approval from the Federal Reserve prior to the payment of dividends from the Bank to the Company or the payment of dividends by the Company or interest on the Company’s junior subordinated debt. The inability of the Bank to pay cash dividends to the Company may hinder the Company’s ability to meet its ongoing operating obligations.

Regulatory Order from the California Department of Business Oversight

On May 20, 2010, the DFI (now known as the Department of Business Oversight (the “DBO”)) issued a formal written order (the “Order”) pursuant to a consent agreement with the Bank as a result of the same June 2009 joint regulatory examination. The terms of the Order were essentially similar to the Federal Reserve’s Agreement, except for a few additional requirements.

On September 24, 2013, the Bank entered into an informal Memorandum of Understanding (the “MOU”) with the DBO and on October 15, 2013, the Order was terminated. The Order and the MOU require the Bank to maintain a ratio of tangible shareholder’s equity to total tangible assets equal to or greater than 9.0% and also requires the DBO’s approval for the Bank to pay a dividend to the Company.

Accordingly, reflecting the Company’s and the Bank’s improved financial condition and performance, as of November 19, 2014, the Bank and the Company have been relieved of all formal regulatory agreements. Some of the governance and procedures established by the Agreement and the Order remain in place, including submission of certain plans and reports to the Federal Reserve and DBO, the Bank’s obligation to maintain a 9.0% tangible shareholder’s equity ratio, and the requirement to seek approvals from the Federal Reserve and the DBO for either the Bank or the Company to pay dividends and for the Company to pay interest on its outstanding junior subordinated debt. While no assurances can be given as to future regulatory approvals, over the last three quarters the DBO and the Federal Reserve have been approving the Bank's payment of dividends to the Company to cover the Company's operating expenses and its interest payments and the Company's payment of quarterly interest on the junior subordinated debt.

The Bank is currently in full compliance with the requirements of the MOU including its deadlines.

Capital Adequacy

The Company (on a consolidated basis) and the Bank are subject to various regulatory capital requirements adopted by the Board of Governors of the Federal Reserve System (the "Board of Governors"). Failure to meet minimum capital requirements can initiate certain mandates and possible additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the consolidated Company and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

Quantitative measures established by the capital adequacy guidelines require insured institutions to maintain a minimum leverage ratio of Tier 1 capital (the sum of common stockholders' equity, noncumulative perpetual preferred stock and minority interests in consolidated subsidiaries, minus intangible assets, identified losses and investments in certain subsidiaries, plus unrealized losses or minus unrealized gains on available for sale securities) to total assets. Institutions which have received the highest composite regulatory rating and which are not experiencing or anticipating significant growth are required to maintain a minimum leverage capital ratio of 3% of Tier 1 capital to total assets. All other institutions are required to maintain a minimum leverage capital ratio of at least 100 to 200 basis points above the 3% minimum requirement.

In addition to the general capital adequacy guidelines, pursuant to the DBO's MOU the Bank is required to maintain a ratio of tangible shareholder's equity to total tangible assets equal to or greater than 9.0%. For purposes of the MOU, "tangible shareholders' equity" is defined as shareholders' equity minus intangible assets. The Bank's ratio of tangible shareholders' equity to total tangible assets was 13.4% and 13.2% at December 31, 2014 and 2013, respectively.

The Company has adopted a capital plan that includes guidelines and trigger points to ensure sufficient capital is maintained at the Bank and the Company, and that capital ratios are maintained at a level deemed appropriate under regulatory guidelines given the level of classified assets, concentrations of credit, ALLL, current and projected growth, and projected retained earnings. The capital plan also contains contingency strategies to obtain additional capital as required to fulfill future capital requirements for both the Bank, as a separate legal entity, and the Company on a consolidated basis.

The following table sets forth the Company's and the Bank's actual capital positions at December 31, 2014, as well as the minimum capital requirements and requirements to be well capitalized under prompt corrective action provisions (Bank required only) under the regulatory guidelines discussed above:

	Company	Bank		To Be Well Capitalized under Prompt Corrective Action Provisions
	Actual Capital Ratios	Actual Capital Ratios	Minimum Capital Ratios	
Total risk-based capital ratio	17.29 %	16.91 %	10.00 %	10.00 %
Tier 1 capital to risk-weighted assets	16.03 %	15.65 %	9.00 %	6.00 %
Leverage ratio	12.49 %	12.25 %	9.00 %	5.00 %

As of December 31, 2014, the Company and the Bank meets all capital adequacy requirements to which they are subject. Management believes that, under the current regulations, both will continue to meet their minimum capital requirements in the foreseeable future.

Dividends

Dividends paid to shareholders by the Company are subject to restrictions set forth in the California General Corporation Law. The California General Corporation Law provides that a corporation may make a distribution to its shareholders if retained earnings immediately prior to the dividend payout are at least equal to the amount of the proposed distribution. The primary source of funds with which dividends will be paid to shareholders will come from cash dividends received by the Company from the Bank.

As noted earlier, the Company and the Bank have entered into an informal agreement with the Federal Reserve Bank and Department of Business Oversight that, among other things, requires prior approval before paying a cash dividend or otherwise making a distribution of stock, increasing debt, repurchasing the Company’s common stock, or any other action which would reduce capital of either the Bank or the Company. In addition, under the agreement with the Federal Reserve Bank, the Company is now prohibited from making interest payments on the junior subordinated debentures without prior approval of the Federal Reserve Bank. During the year ended December 31, 2014, the Bank’s cash dividends of $1,519,000 paid to the Company were approved by the Federal Reserve and the DBO and funded the Company’s operating costs and payments of interest on its junior subordinated debentures.

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The Bank, as a state-chartered bank, is subject to dividend restrictions set forth in California state banking law and administered by the Commissioner of the California Department of Business Oversight ("Commissioner"). Under such restrictions, the Bank may not pay cash dividends in an amount which exceeds the lesser of the retained earnings of the Bank or the Bank's net income for the last three fiscal years (less the amount of distributions to shareholders during that period of time). If the above test is not met, cash dividends may only be paid with the prior approval of the Commissioner, in an amount not exceeding the Bank's net income for its last fiscal year or the amount of its net income for the current fiscal year. Such restrictions do not apply to stock dividends, which generally require neither the satisfaction of any tests nor the approval of the Commissioner. Notwithstanding the foregoing, if the Commissioner finds that the shareholders' equity is not adequate or that the declarations of a dividend would be unsafe or unsound, the Commissioner may order the state bank not to pay any dividend. The FRB may also limit dividends paid by the Bank. As noted above, the terms of the informal agreement with the Federal Reserve prohibit both the Company and the Bank from paying dividends without prior approval of the Federal Reserve.

Reserve Balances

The Bank is required to maintain average reserve balances with the Federal Reserve Bank. During 2005, the Company implemented a deposit reclassification program, which allows the Company to reclassify a portion of transaction accounts to non-transaction accounts for reserve purposes. The deposit reclassification program was provided by a third-party vendor, and has been approved by the Federal Reserve Bank. At December 31, 2014, the bank was not subject to a reserve requirement.

Item 8 - Financial Statements and Supplementary Data

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MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Management of United Security Bancshares and Subsidiaries (the "Company") is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, and for performing an assessment of the effectiveness of internal control over financial reporting as of December 31, 2014. The Company's internal control over financial reporting is a process designed under the supervision of the Company's management, including the Chief Executive Officer and Chief Financial Officer, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States.

The Company's system of internal control over financial reporting includes policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect transactions and dispositions of assets of the Company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Management recognizes that there are inherent limitations in the effectiveness of any system of internal control, and accordingly, even effective internal control can provide only reasonable assurance with respect to financial statement preparation and fair presentation. Further, because of changes in conditions, the effectiveness of internal control may vary over time.

Under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, the Company performed an assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2014 based upon criteria in Internal Control — Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). As a result of this assessment, management has concluded that the Company's internal control over financial reporting was effective as of December 31, 2014.

As a result of the enactment in our third quarter of the Dodd-Frank Wall Street Reform and Consumer Protection Act, "Exemption for Non-accelerated Filers," and in accordance with section 989G of the act, we are not required to provide an attestation report of our independent registered public accounting firm regarding internal control over financial reporting for this fiscal year or thereafter, until such time as we are no longer eligible for the exemption set forth therein.

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Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders
United Security Bancshares and Subsidiary

We have audited the accompanying consolidated balance sheets of United Security Bancshares and Subsidiary (Company) as of December 31, 2014 and 2013, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity and cash flows for each of the two years in the period ended December 31, 2014. These consolidated financial statements are the responsibility of Company’s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of United Security Bancshares and Subsidiary as of December 31, 2014 and 2013, and the consolidated results of their operations and their cash flows for each of the two years in the period ended December 31, 2014, in conformity with accounting principles generally accepted in the United States of America.

/s/ Moss Adams LLP

Stockton, California
March 17, 2015

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United Security Bancshares and Subsidiaries
Consolidated Balance Sheets
December 31, 2014 and 2013

(In thousands except shares)	December 31, 2014	December 31, 2013
Assets		
Cash and due from banks	$21,348	$20,193
Cash and due from FRB	82,229	115,019
Cash and cash equivalents	103,577	135,212
Interest-bearing deposits in other banks	1,522	1,515
Investment securities available for sale (at fair value)	48,301	43,616
Loans	457,919	395,317
Unearned fees	(324)	(304)
Allowance for credit losses	(10,771)	(10,988)
Net loans	446,824	384,025
Accrued interest receivable	1,927	1,644
Premises and equipment - net	11,550	12,122
Other real estate owned	14,010	13,946
Intangible assets	—	62
Goodwill	4,488	4,488
Cash surrender value of life insurance	17,717	17,203
Investment in limited partnerships	871	4,534
Deferred income taxes	6,853	11,630
Other assets	5,529	5,932
Total assets	$663,169	$635,929
Liabilities & Shareholders' Equity		
Liabilities		
Deposits		
Noninterest bearing	$215,439	$214,317
Interest bearing	349,934	328,172
Total deposits	565,373	542,489
Accrued interest payable	40	44
Accounts payable and other liabilities	4,815	5,728
Junior subordinated debt (at fair value)	10,115	11,125
Total liabilities	580,343	559,386
Shareholders' Equity		
Common stock, no par value 20,000,000 shares authorized, 15,425,086 issued and outstanding at December 31, 2014, and 14,799,888 at December 31, 2013	49,271	45,778
Retained earnings	33,730	30,884
Accumulated other comprehensive loss	(175)	(119)
Total shareholders' equity	82,826	76,543
Total liabilities and shareholders' equity	$663,169	$635,929

See notes to consolidated financial statements

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United Security Bancshares and Subsidiaries
Consolidated Statements of Income
Years Ended December 31, 2014 and 2013

(In thousands except shares and EPS)	December 31, 2014	December 31, 2013
Interest Income		
Loans, including fees	$23,777	$21,979
Investment securities - AFS – taxable	901	703
Interest on deposits in Federal Reserve Bank	277	312
Interest on deposits in other banks	7	8
Total interest income	24,962	23,002
Interest Expense		
Interest on deposits	1,104	1,330
Interest on other borrowed funds	241	281
Total interest expense	1,345	1,611
Net Interest Income Before Credit Losses	23,617	21,391
Benefit for Credit Losses	(845)	(1,098)
Net Interest Income	24,462	22,489
Noninterest Income		
Customer service fees	3,473	3,456
Increase in cash surrender value of bank owned life insurance	514	556
Loss on fair value of financial liability	(102)	(776)
Gain on sale of fixed assets	25	—
Gain on sale of other investment	691	—
Other	560	732
Total noninterest income	5,161	3,968
Noninterest Expense		
Salaries and employee benefits	9,653	9,214
Occupancy expense	3,760	3,678
Data processing	134	185
Professional fees	1,456	1,275
Regulatory assessments	943	1,150
Director fees	232	232
Amortization of intangibles	62	187
Correspondent bank service charges	117	287
Loss on California tax credit partnership	39	253
Net cost on operation and sale of OREO	571	271
Other	2,248	2,351
Total noninterest expense	19,215	19,083
Income Before Provision for Taxes on Income	10,408	7,374
Provision for Taxes on Income	4,192	105
Net Income	$6,216	$7,269
Net Income per common share		
Basic	$0.40	$0.49
Diluted	$0.40	$0.49
Shares on which net income per common share were based		
Basic	15,410,733	15,398,911
Diluted	15,415,664	15,399,516

See notes to consolidated financial statements

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United Security Bancshares and Subsidiaries
Consolidated Statements of Comprehensive Income
Years Ended December 31, 2014 and 2013

	Year Ended December 31,	
(In thousands)	2014	2013
Net Income	$6,216	$7,269
Unrealized holdings gains (losses) on securities	18	(617)
Unrealized (losses) gains on unrecognized post retirement costs	(113)	275
Other comprehensive loss, before tax	(95)	(342)
Tax (expense) benefit related to securities	(7)	247
Tax benefit (expense) related to unrecognized post retirement costs	46	(113)
Total other comprehensive loss	(56)	(208)
Comprehensive income	$6,160	$7,061

See notes to consolidated financial statements

United Security Bancshares and Subsidiaries
Consolidated Statements of Changes in Shareholders' Equity
Years Ended December 31, 2014 and 2013

	Common stock				
(In thousands except shares)	Number of Shares	Amount	Retained Earnings	Accumulated Other Comprehensive Income	Total
Balance January 1, 2013	14,217,303	$43,173	$26,179	$89	$69,441
Other comprehensive loss				(208)	(208)
Common stock dividends	577,383	2,564	(2,564)		—
Common stock issuance	5,202	12			12
Stock-based compensation expense		29			29
Net Income			7,269		7,269
Balance December 31, 2013	14,799,888	$45,778	$30,884	$(119)	$76,543
Other comprehensive loss				(56)	(56)
Common stock dividends	601,276	3,370	(3,370)		—
Stock options exercised	23,922	95			95
Stock-based compensation expense		28			28
Net Income			6,216		6,216
Balance December 31, 2014	15,425,086	$49,271	$33,730	$(175)	$82,826

See notes to consolidated financial statements

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United Security Bancshares and Subsidiaries
Consolidated Statements of Cash Flows
Years Ended December 31, 2014 and 2013

(In thousands)	December 31, 2014	December 31, 2013
Cash Flows From Operating Activities:		
Net Income	$6,216	$7,269
Adjustments to reconcile net income to cash provided by operating activities:		
Benefit for credit losses	(845)	(1,098)
Depreciation and amortization	1,365	1,287
Amortization of investment securities	263	52
Accretion of investment securities	(33)	(60)
(Increase) decrease in accrued interest receivable	(283)	50
Decrease in accrued interest payable	(4)	(27)
Increase in unearned fees	20	280
(Decrease) increase in income taxes payable	(398)	5,557
Stock-based compensation expense	28	29
Provision (benefits) for deferred income taxes	4,816	(1,773)
(Decrease) increase in accounts payable and accrued liabilities	(1,113)	265
Gain on sale of investment in limited partnership	(691)	—
Gain on sale of other real estate owned	(114)	(1,346)
Impairment loss on other real estate owned	—	214
Loss on fair value option of financial liabilities	102	776
Increase in surrender value of life insurance	(514)	(589)
Loss on tax credit limited partnership interest	39	253
Gain on sale of premises and equipment	(25)	—
Amortization of CDI	62	187
Net increase in other assets	111	577
Net cash provided by operating activities	9,002	11,903
Cash Flows From Investing Activities:		
Net increase in interest-bearing deposits with banks	(7)	(8)
Redemption of correspondent bank stock	—	433
Purchase of correspondent bank stock	(97)	—
Maturities and calls on available-for-sale securities	—	3,600
Principal payments on available-for-sale securities	5,295	4,452
Purchases of available-for-sale securities	(10,192)	(20,433)
Net (increase) decrease in loans	(60,282)	6,933
Cash proceeds from sales of other real estate owned	1,308	9,202
Cash proceeds from sale of other investment	1,253	—
Capital expenditures for premises and equipment	(768)	(1,147)
Investment in limited partnership	(126)	(564)
Net cash provided by (used in) investing activities	(63,616)	2,468
Cash Flows From Financing Activities:		
Net increase (decrease) in demand deposit and savings accounts	28,225	(4,899)
Net decrease in certificates of deposit	(5,341)	(15,899)
Proceeds from exercise of stock options	95	12
Cash proceeds from the issuance of common stock	—	—
Net cash (used in) financing activities	22,979	(20,786)
Net (decrease) increase in cash and cash equivalents	(31,635)	(6,415)

Cash and cash equivalents at beginning of year	135,212	141,627
Cash and cash equivalents at end of year	$103,577	$135,212

See notes to consolidated statements

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Notes to Consolidated Financial Statements
Years Ended December 31, 2014 and 2013

1. Organization and Summary of Significant Accounting and Reporting Policies

Basis of Presentation – The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States and with prevailing practices within the banking industry. The consolidated financial statements include the accounts of United Security Bancshares, and its wholly owned subsidiary, United Security Bank and subsidiary (the “Bank”). USB Capital Trust II (the “Trust”) is deconsolidated pursuant to ASC 810. As a result, the Trust Preferred Securities are not presented on the Company’s consolidated financial statements as equity, but instead the Company’s Subordinated Debentures are presented as a separate liability category. (see Note 8 to the Company’s consolidated financial statements). Intercompany accounts and transactions have been eliminated in consolidation. In the following notes, references to the Bank are references to United Security Bank. References to the Company are references to United Security Bancshares, (including the Bank). United Security Bancshares operates as one business segment providing banking services to commercial establishments and individuals primarily in the San Joaquin Valley of California.

Nature of Operations – United Security Bancshares is a bank holding company, incorporated in the state of California for the purpose of acquiring all the capital stock of the Bank through a holding company reorganization (the “Reorganization”) of the Bank. The Reorganization, which was accounted for in a manner similar to a pooling of interests, was completed on June 12, 2001. Management believes the Reorganization has provided the Company greater operating and financial flexibility and has permitted expansion into a broader range of financial services and other business activities.

During July 2007 the Company formed USB Capital Trust II and issued $15.0 million in Trust Preferred Securities with terms similar to those originally issued under USB Capital Trust I. (See Note 8. “Junior Subordinated Debt/Trust Preferred Securities”).

USB Investment Trust Inc was incorporated effective December 31, 2001, as a special purpose real estate investment trust (“REIT”) under Maryland law. The REIT is a subsidiary of the Bank and was funded with $133.0 million in real estate-secured loans contributed by the Bank. USB Investment Trust was originally formed to give the Bank flexibility in raising capital, and reduce the expenses associated with holding the assets contributed to USB Investment Trust.

The Bank was founded in 1987 and currently operates eleven branches and one construction lending office in an area from eastern Madera County to western Fresno County, as well as Taft and Bakersfield in Kern County, and Campbell in Santa Clara County. The Bank also operates one financial services department located in Fresno, California. The Bank’s primary source of revenue is interest income through providing loans to customers, who are predominantly small and middle-market businesses and individuals. The Bank engages in a full compliment of lending activities, including real estate mortgage, commercial and industrial, real estate construction, agricultural and consumer loans, with particular emphasis on short and medium term obligations.

The Bank offers a wide range of deposit instruments. These include personal and business checking accounts and savings accounts, interest-bearing negotiable order of withdrawal ("NOW") accounts, money market accounts and time certificates of deposit. Most of the Bank's deposits are attracted from individuals and from small and medium-sized business-related sources.

The Bank also offers a wide range of specialized services designed to attract and service the needs of commercial customers and account holders. These services include cashiers checks, travelers checks, money orders, and foreign drafts. In addition, the Bank offers Internet banking services to its commercial and retail customers, and offers certain financial and wealth management services through its financial services department. The Bank does not operate a trust department, however it makes arrangements with its correspondent bank to offer trust services to its customers upon request.

Use of Estimates in the Preparation of Financial Statements - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change, relate to the determination of the allowance for loan losses, determination of goodwill, fair value of junior subordinated debt and certain collateralized mortgage obligations, and the valuation of real estate acquired in connection with foreclosures or in satisfaction of loans.

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Subsequent events—The Company has evaluated events and transactions for potential recognition or disclosure through the day the financial statements were issued.

Significant Accounting Policies - The Company follows accounting standards set by the Financial Accounting Standards Board, commonly referred to as the "FASB". The FASB sets generally accepted accounting principles (GAAP) that the Company follows to ensure the consistent reporting of its consolidated financial condition, consolidated results of operations, and consolidated cash flows. References to GAAP issued by the FASB in these footnotes are to the FASB Accounting Standards Codification, sometimes referred to as the Codification or ASC. The following is a summary of significant policies:

a. Cash and cash equivalents – Cash and cash equivalents include cash on hand, amounts due from banks, federal funds sold and repurchase agreements. At times throughout the year, balances can exceed FDIC insurance limits. Generally, federal funds sold and repurchase agreements are sold for one-day periods. The Bank did not have any repurchase agreements during 2014 or 2013, or at December 31, 2014 and 2013. All cash and cash equivalents have maturities when purchased of three months or less.
b. Securities - Debt and equity securities classified as available for sale are reported at fair value, with unrealized gains and losses excluded from net income and reported, net of tax, as a separate component of comprehensive income and shareholders' equity. Debt securities classified as held to maturity are carried at amortized cost. Gains and losses on disposition are reported using the specific identification method for the adjusted basis of the securities sold. Premiums and discounts are recognized in interest income using the interest method over the period to maturity.

The Company classifies its securities as available for sale or held to maturity, and periodically reviews its investment portfolio on an individual security basis. Securities that are to be held for indefinite periods of time (including, but not limited to, those that management intends to use as part of its asset/liability management strategy, those which may be sold in response to changes in interest rates, changes in prepayments or any such other factors) are classified as securities available for sale. Securities which the Company has the ability and intent to hold to maturity are classified as held to maturity.

Investments with fair values that are less than amortized cost are considered impaired. Impairment may result from either a decline in the financial condition of the issuing entity or, in the case of fixed interest rate investments, from rising interest rates. At each financial statement date, management assesses each investment to determine if impaired investments are temporarily impaired or if the impairment is other-than-temporary based upon the positive and negative evidence available. Evidence evaluated includes, but is not limited to, industry analyst reports, credit market conditions, and interest rate trends. Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the entire difference between the amortized cost and fair value is recognized as impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: (1) OTTI related to credit loss, which must be recognized in the income statement; and (2) OTTI related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis. For equity securities, the entire amount of impairment is recognized through earnings.

c. Loans - Interest income on loans is credited to income as earned and is calculated by using the simple interest method on the daily balance of the principal amounts outstanding. Loans are placed on non-accrual status when principal or interest is past due for 90 days and/or when management believes the collection of amounts due is doubtful. For loans placed on nonaccrual status, the accrued and unpaid interest receivable may be reversed at management's discretion based upon management's assessment of collectibility, and interest is thereafter credited to principal to the extent necessary to eliminate doubt as to the collectibility of the net carrying amount of the loan.

Nonrefundable fees and related direct costs associated with the origination or purchase of loans are deferred and netted against outstanding loan balances. The net deferred fees and costs are generally amortized into interest income over the loan term using the interest method. Other credit-related fees, such as standby letter of credit fees, loan placement fees and annual credit card fees are recognized as noninterest income during the period the related service is performed.

d. Allowance for Credit Losses and Reserve for Unfunded Loan Commitments - The allowance for credit losses is maintained to provide for losses that can reasonably be anticipated. The allowance is based on ongoing quarterly assessments of the probable losses inherent in the loan portfolio, and to a lesser extent, unfunded loan commitments. The reserve for unfunded loan commitments is a liability on the Company's consolidated financial statements and is included in other liabilities. The liability is computed using a methodology similar to that used to determine the allowance for credit losses, modified to take into account the probability of a drawdown on the commitment.

The allowance for credit losses is increased by provisions charged to or decreased by benefits credited to operations during the current period and reduced by negative provisions and loan charge-offs, net of recoveries. Loans are charged against the allowance when management believes that the collection of the principal is unlikely. The allowance is an amount that management believes will be adequate to absorb losses inherent in existing loans, based on evaluations of the probability of collection. In evaluating the probability of collection, management is required to make estimates and assumptions that affect the reported amounts of loans, allowance for credit losses and the provision for credit losses charged to operations. Actual results could differ significantly from those estimates. These evaluations take into consideration such factors as the composition of the portfolio, overall portfolio quality, loan concentrations, specific problem loans, and current economic conditions that may affect the borrowers' ability to pay.

The Company's methodology for assessing the adequacy of the allowance for credit losses consists of several key elements, which include:

- the formula allowance
- specific allowances for problem graded loans identified as impaired
- and the unallocated allowance

The formula allowance is calculated by applying loss factors to outstanding loans and certain unfunded loan commitments. Loss factors are based on the Company's historical loss experience and on the internal risk grade of those loans and, may be adjusted for significant factors, including economic factors that, in management's judgment, affect the collectability of the portfolio as of the evaluation date. Management determines the loss factors for problem graded loans (substandard, doubtful, and loss), special mention loans, and pass graded loans, based on a loss migration model. The migration analysis incorporates loan losses over the previous quarters as determined by management (time horizons adjusted as business cycles or environment changes) and loss factors are adjusted to recognize and quantify the loss exposure from changes in market conditions and trends in the Company's loan portfolio. Those factors include 1) trends in delinquent and nonaccrual loans, 2) trends in loan volume and terms, 3) effects of changes in lending policies, 4) concentrations of credit, 5) competition, 6) national and local economic trends and conditions, 7) experience of lending staff, 8) loan review and Board of Directors oversight, 9) high balance loan concentrations, and 10) other business conditions. For purposes of this analysis, loans are grouped by internal risk classifications, which are "pass", "special mention", "substandard", "doubtful", and "loss". Certain loans are homogeneous in nature and are therefor pooled by risk grade. These homogeneous loans include consumer installment and home equity loans.

Specific allowances are established based on management's periodic evaluation of loss exposure inherent in impaired loans. For impaired loans, specific allowances are determined based on the collateralized value of the underlying properties, the net present value of the anticipated cash flows, or the market value of the underlying assets.

A loan is considered impaired when management determines that it is probable that the Company will be unable to collect all amounts due according to the original contractual terms of the loan agreement. Impairment is measured by the difference between the original recorded investment in the loan and the estimated present value of the total expected future cash flows, discounted at the loan's effective rate, or the fair value of the collateral, less estimated selling costs, if the loan is collateral dependent.

The unallocated portion of the allowance is based upon management's evaluation of various conditions that are not directly measured in the determination of the formula and specific allowances. The conditions may include, but are not limited to, general economic and business conditions affecting the key lending areas of the Company, credit quality trends, collateral values, loan volumes and concentrations, and other business conditions.

e. Premises and Equipment - Premises and equipment are carried at cost less accumulated depreciation. Depreciation expense is computed principally on the straight-line method over the estimated useful lives of the assets. Estimated useful lives are as follows:

Buildings	31 years	Furniture and equipment	3-7 Years

f. Other Real Estate Owned - Real estate properties acquired through, or in lieu of, loan foreclosure are to be sold and are initially recorded at fair value of the property, less estimated costs to sell. The excess, if any, of the loan amount over the

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fair value is charged to the allowance for credit losses. Subsequent declines in the fair value of other real estate owned, along with related revenue and expenses from operations, are charged to noninterest expense.

g. Intangible Assets and Goodwill - Intangible assets are comprised of core deposit intangibles, other specific identifiable intangibles, and goodwill acquired in branch acquisitions where the consideration given exceeded the fair value of the net assets acquired. Intangible assets and goodwill are reviewed at least annually for impairment. Core deposit intangibles of $0 and $62,000 (net of accumulated amortization and impairment losses of $6,996,000 and $6,934,000) at December 31, 2014 and 2013, respectively, are amortized over the estimated useful lives of the existing deposit bases (average of 7 years) using a method which approximates the interest method. During 2014 and 2013, the Company recognized no impairment losses on the core deposit intangible related to the deposits purchased in the Legacy merger consummated during February 2007. The Company estimates no aggregate amortization expense related to intangible assets for the next five years.

Goodwill amounts resulting from the acquisitions of Taft National Bank during April 2004, and Legacy Bank during February 2007 are considered to have an indefinite life and are not amortized. At December 31, 2014, goodwill related to Taft National Bank totaled $1.6 million, and goodwill related to Legacy Bank totaled $2.9 million. Impairment testing of goodwill is performed at the reporting level during April of each year for Taft, and during March of each year for Legacy. During 2014 and 2013, the Company did not recognize impairment adjustments on the goodwill related to the Legacy or Taft Bank mergers (see Note 19 to the Company’s consolidated financial statements contained herein for details of the goodwill impairment.)

h. Income Taxes - Deferred income taxes are provided for the temporary differences between the financial reporting basis and the tax basis of the Company's assets and liabilities using the liability method, and are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled.

i. Net Income per Share - Basic income per common share is computed based on the weighted average number of common shares outstanding. Diluted income per share includes the effect of stock options and other potentially dilutive securities using the treasury stock method to the extent they have a dilutive impact. Net income per share has been retroactively adjusted for all stock dividends declared.

j. Cash Flow Reporting - For purposes of reporting cash flows, cash and cash equivalents include cash on hand, noninterest-bearing amounts due from banks, federal funds sold and securities purchased under agreements to resell. Federal funds and securities purchased under agreements to resell are generally sold for one-day periods. Net cash flows are reported for interest-bearing deposits with other banks, loans to customers, and deposits held for customers.

k. Transfers of Financial Assets - Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

l. Advertising Costs - The Company expenses marketing costs as they are incurred. Advertising expense was $123,000 and $92,000 for the years ended December 31, 2014 and 2013, respectively.

m. Stock Based Compensation - The Company has a stock-based employee compensation plan, which is described more fully in Note 10. The Company accounts for all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on the grant-–date fair value of the award. The fair value is amortized over the requisite service period (generally the vesting period). Included in salaries and employee benefits for the years ended December 31, 2014 and 2013 is $28,000, and $29,000, respectively, of share-based compensation. The related tax benefit, recorded in the provision for income taxes, was not significant. All share data contained within the financial statements has been retroactively restated for stock based transactions (i.e. stock splits and stock dividends.)

n.

Federal Home Loan Bank stock and Federal Reserve Stock - As a member of the Federal Home Loan Bank (FHLB), the Company is required to maintain an investment in capital stock of the FHLB. In addition, as a member of the Federal Reserve Bank (FRB), the Company is required to maintain an investment in capital stock of the FRB. The investments in both the FHLB and the FRB are carried at cost, which approximates their fair value, in the accompanying consolidated balance sheets under other assets and are subject to certain redemption requirements by the FHLB and FRB. Stock redemptions are at the discretion of the FHLB and FRB.

While technically these are considered equity securities, there is no market for the FHLB or FRB stock. Therefore, the shares are considered as restricted investment securities. Management periodically evaluates the stock for other-than-

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temporary impairment. Management's determination of whether these investments are impaired is based on its assessment of the ultimate recoverability of cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of cost is influenced by criteria such as (1) the significance of any decline in net assets of the FHLB or FRB as compared to the capital stock amount of the FHLB or FRB and the length of time this situation has persisted, (2) commitments by the FHLB or FRB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB or FRB, (3) the impact of legislative and regulatory changes on institutions and, accordingly, the customer base of the FHLB or FRB, and (4) the liquidity position of the FHLB or FRB.

o. Comprehensive Income - Comprehensive income is comprised of net income and other comprehensive income. Other comprehensive income includes items recorded directly to equity, such as unrealized gains and losses on securities available-for-sale, unrecognized costs of salary continuation defined benefit plans. Comprehensive income is presented in the Consolidated Statements of Other Comprehensive Income.

p. Segment Reporting - The Company's operations are solely in the financial services industry and include providing to its customers traditional banking and other financial services. The Company operates primarily in the San Joaquin Valley region of California. Management makes operating decisions and assesses performance based on an ongoing review of the Company's consolidated financial results. Therefore, the Company has a single operating segment for financial reporting purposes.

q. New Accounting Standards:

In January 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-01 Accounting for Investments in Qualified Affordable Housing Projects. This ASU provides "guidance on accounting for investments by a reporting entity in flow-through limited liability entities that manage or invest in affordable housing projects that qualify for the low-income housing tax credit." It allows the proportional amortization method to be used by a reporting entity if certain conditions are met. The ASU also defines when a qualified affordable housing project through a limited liability entity should be tested for impairment. If a qualified affordable housing project does not meet the conditions for using the proportional amortization method, the investment should be accounted for using an equity method investment or a cost method investment. The ASU is effective for fiscal years beginning after December 15, 2014, and interim periods therein. This ASU did not have a significant impact on the Company's financial statements.

In November 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-04 Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure. The amendments in the ASU clarify when an in substance repossession or foreclosure occurs - that is, when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan receivable should be derecognized and the real estate property recognized. The new ASU requires a creditor to reclassify a collateralized consumer mortgage loan to real estate property upon obtaining legal title to the real estate collateral, or the borrower voluntarily conveying all interest in the real estate property to the lender to satisfy the loan through a deed in lieu of foreclosure or similar legal agreement. The ASU is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. This ASU did not have a significant impact on the Company's financial statements.

In February 2013, The Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2013-02, Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income, to improve the transparency of reporting reclassifications out of accumulated other comprehensive income. ASU 2013-02 requires an organization to present (either on the face of the statement where net income is presented or in the notes) the effects on the line items of net income of significant amounts reclassified out of accumulated other comprehensive income–but only if the item reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period. The amendments are effective for reporting periods beginning after December 15, 2012. The amounts reclassified out of net income were not significant and this ASU did not have a significant impact on the Company's financial statements.

In January 2013, the FASB issued ASU No. 2013-01 Balance Sheet (Topic 210) Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities, which clarifies that ordinary trade receivables and receivables are not in the scope of ASU 2011-11. It further clarifies that the scope of ASU No. 2011-11 applies to derivatives, repurchase agreements and reverse purchase agreements, and securities borrowing and securities lending transactions that are either offset in accordance with specific criteria contained in FASB Accounting Standards Codification® or subject to a master netting arrangement or similar agreement. Both ASU 2011-11 and ASU 2013-1 are effective for annual periods beginning on or after January 1,

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2013, and interim periods within those annual periods. The Company adopted these ASUs during the first quarter of 2013 and they did not have a material impact on its financial statements.

r. Reclassifications - Certain reclassifications have been made to prior year financial statements to conform to the classifications used in 2014. None of the reclassifications had an impact on equity or net income.

2. Investment Securities

Following is a comparison of the amortized cost and approximate fair value of investment securities at December 31, 2014 and December 31, 2013:

(In thousands) December 31, 2014 Securities available for sale:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value (Carrying Amount)
U.S. Government agencies	$12,097	$399	—	$12,496
U.S. Government sponsored entities & agencies collateralized by mortgage obligations	31,659	336	(13)	31,982
Mutual Funds	4,000	—	(177)	3,823
Total securities available for sale	$47,756	$735	$(190)	$48,301
December 31, 2013				
Securities available for sale:				
U.S. Government agencies	$14,060	$441	$—	$14,501
U.S. Government sponsored entities & agencies collateralized by mortgage obligations	25,029	434	(78)	25,385
Mutual Funds	4,000	—	(270)	3,730
Total securities available for sale	$43,089	$875	$(348)	$43,616

There were no sales of securities and no gross realized losses on available-for-sale securities and no gross gains during the years ended December 31, 2014 and 2013.

The amortized cost and fair value of securities available for sale at December 31, 2014, by contractual maturity, are shown below. Actual maturities may differ from contractual maturities because issuers have the right to call or prepay obligations with or without call or prepayment penalties. Contractual maturities on collateralized mortgage obligations cannot be anticipated due to allowed paydowns.

	December 31, 2014	
(In thousands)	Amortized Cost	Fair Value (Carrying Amount)
Due in one year or less	$4,000	$3,823
Due after one year through five years	30	31
Due after five years through ten years	—	—
Due after ten years	12,067	12,465
U.S. Government sponsored entities & agencies collateralized by mortgage obligations	31,659	31,982
	$47,756	$48,301

At December 31, 2014 and 2013, available-for-sale securities with an amortized cost of approximately $20,865,000 and $23,935,000 (fair value of $21,503,000 and $24,739,000) were pledged as collateral for FHLB borrowings and public funds balances, respectively.

The Company had no held-to-maturity or trading securities at December 31, 2014 and 2013.

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

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The following summarizes temporarily impaired investment securities at December 31, 2014 and 2013:

	Less than 12 Months		12 Months or More		Total	
(In thousands) December 31, 2014 Securities available for sale:	Fair Value (Carrying Amount)	Unrealized Losses	Fair Value (Carrying Amount)	Unrealized Losses	Fair Value (Carrying Amount)	Unrealized Losses
U.S. Government agencies	$—	$—	$—	$—	$—	$—
U.S. Government sponsored entities & agencies collateralized by mortgage obligations	6,478	(13)	—	—	6,478	(13)
Mutual Funds	—	—	3,823	(177)	3,823	(177)
Total impaired securities	$6,478	$(13)	$3,823	$(177)	$10,301	$(190)
December 31, 2013						
Securities available for sale:						
U.S. Government agencies	$—	$—	$—	$—	$—	$—
U.S. Government sponsored entities & agencies collateralized by mortgage obligations	11,069	(78)	—	—	11,069	(78)
Mutual Funds	0	0	3,730	(270)	3,730	(270)
Total impaired securities	$11,069	$(78)	$3,730	$(270)	$14,799	$(348)

Temporarily impaired securities at December 31, 2014, were comprised of four U.S. Government sponsored entities & agencies collateralized by mortgage obligations and one mutual fund. Temporarily impaired securities at December 31, 2013, were comprised of one mutual fund, with an undefined maturity date.

The Company evaluates investment securities for other-than-temporary impairment (“OTTI”) at least quarterly, and more frequently when economic or market conditions warrant such an evaluation. The investment securities portfolio is evaluated for OTTI by segregating the portfolio into two general segments and applying the appropriate OTTI model. Investment securities of high credit quality are generally evaluated for OTTI under ASC Topic 320-10, “Investments – Debt and Equity Instruments.” Certain purchased beneficial interests, including non-agency mortgage-backed securities, asset-backed securities, and collateralized debt obligations, are evaluated under ASC Topic 325-40, Beneficial Interest in Securitized Financial Assets.

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

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

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

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applicable taxes. The previous amortized cost basis less the other-than-temporary-impairment recognized in earnings shall become the new amortized cost basis of the investment.

3. Loans

Loans are comprised of the following:

In thousands)	December 31, 2014	December 31, 2013
Commercial and Business loans	$60,422	$68,460
Government program loans	1,947	2,226
Total Commercial and Industrial	62,369	70,686
Real estate – mortgage:		
Commercial real estate	154,672	143,919
Residential mortgages	59,095	52,036
Home Improvement and Home Equity loans	1,110	1,410
Total Real Estate Mortgage	214,877	197,365
RE Construction and Development	137,158	87,004
Agricultural Loans	31,713	30,932
Installment	11,802	9,330
Total Loans	$457,919	$395,317

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

Commercial and industrial loans represent 13.6% of total loans at December 31, 2014, and are generally made to support the ongoing operations of small-to-medium sized commercial businesses. Commercial and industrial loans have a high degree of industry diversification and provide, working capital, financing for the purchase of manufacturing plants and equipment, or funding for growth and general expansion of businesses. A substantial portion of commercial and industrial loans are secured by accounts receivable, inventory, leases or other collateral including real estate. The remainder are unsecured; however, extensions of credit are predicated upon the financial capacity of the borrower. Repayment of commercial loans is generally from the cash flow of the borrower.

Real estate mortgage loans, representing 46.9% of total loans at December 31, 2014, are secured by trust deeds on primarily commercial property, but are also secured by trust deeds on single family residences. Repayment of real estate mortgage loans is generally from the cash flow of the borrower.

- Commercial real estate mortgage loans comprise the largest segment of this loan category and are available on all types of income producing and commercial properties, including: office buildings, shopping centers; apartments and motels; owner occupied buildings; manufacturing facilities and more. Commercial real estate mortgage loans can also be used to refinance existing debt. Although real estate associated with the business is the primary collateral for commercial real estate mortgage loans, the underlying real estate is not the source of repayment. Commercial real estate loans are made under the premise that the loan will be repaid from the borrower's business operations, rental income associated with the real property, or personal assets.
- Residential mortgage loans are provided to individuals to finance or refinance single-family residences. Residential mortgages are not a primary business line offered by the Company, and are generally of a shorter term than conventional mortgages, with maturities ranging from three to fifteen years on average.

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

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Real estate construction and development loans, representing 30.0% of total loans at December 31, 2014, consist of loans for residential and commercial construction projects, as well as land acquisition and development, or land held for future development. Loans in this category are secured by real estate including improved and unimproved land, as well as single-family residential, multi-family residential, and commercial properties in various stages of completion. All real estate loans have established equity requirements. Repayment on construction loans is generally from long-term mortgages with other lending institutions obtained at completion of the project.

Agricultural loans represent 6.9% of total loans at December 31, 2014, and are generally secured by land, equipment, inventory and receivables. Repayment is from the cash flow of the borrower.

In the normal course of business, the Company is party to financial instruments with off-balance sheet risk to meet the financing needs of its customers. At December 31, 2014 and 2013, these financial instruments include commitments to extend credit of $105,434,000 and $63,271,000, respectively, and standby letters of credit of $3,800,000 and $2,001,000, respectively. These instruments involve elements of credit risk in excess of the amount recognized on the balance sheet. The contract amounts of these instruments reflect the extent of the involvement the Company has in off-balance sheet financial instruments.

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

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

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

Loans to directors, officers, principal shareholders and their affiliates are summarized below:

	December 31,	
(In thousands)	2014	2013
Aggregate amount outstanding, beginning of year	2,916	3,330
New loans or advances during year	796	1,098
Repayments during year	(1,592)	(1,512)
Aggregate amount outstanding, end of year	$2,120	$2,916
Loan commitments	$3,761	$3,930

Past Due Loans

The Company monitors delinquency and potential problem loans on an ongoing basis through weekly reports to the Loan Committee and monthly reports to the Board of Directors. The following is a summary of delinquent loans at December 31, 2014 (in thousands):

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December 31, 2014	Loans 30-60 Days Past Due	Loans 61-89 Days Past Due	Loans 90 or More Days Past Due	Total Past Due Loans	Current Loans	Total Loans	Accruing Loans 90 or More Days Past Due
Commercial and Business Loans	$962	$—	$—	$962	$59,460	$60,422	$—
Government Program Loans	445	—	—	445	1,502	1,947	—
Total Commercial and Industrial	1,407	—	—	1,407	60,962	62,369	—
Commercial Real Estate Loans	463	—	—	463	154,209	154,672	—
Residential Mortgages	—	90	162	252	58,843	59,095	—
Home Improvement and Home Equity Loans	43	—	42	85	1,025	1,110	—
Total Real Estate Mortgage	506	90	204	800	214,077	214,877	—
RE Construction and Development Loans	—	—	—	—	137,158	137,158	—
Agricultural Loans	—	—	—	—	31,713	31,713	—
Consumer Loans	67	—	—	67	11,428	11,495	—
Overdraft protection Lines	—	—	—	—	92	92	—
Overdrafts	—	—	—	—	215	215	—
Total Installment	67	—	—	67	11,735	11,802	—
Total Loans	$1,980	$90	$204	$2,274	$455,645	$457,919	$—

The following is a summary of delinquent loans at December 31, 2013 (in thousands):

December 31, 2013	Loans 30-60 Days Past Due	Loans 61-89 Days Past Due	Loans 90 or More Days Past Due	Total Past Due Loans	Current Loans	Total Loans	Accruing Loans 90 or More Days Past Due
Commercial and Business Loans	$—	$94	$—	$94	$68,366	$68,460	$—
Government Program Loans	—	—	—	—	2,226	2,226	—
Total Commercial and Industrial	—	94	—	94	70,592	70,686	—
Commercial Real Estate Loans	1,991	—	6,866	8,857	135,062	143,919	—
Residential Mortgages	—	614	359	973	51,063	52,036	—
Home Improvement and Home Equity Loans	96	—	—	96	1,314	1,410	—
Total Real Estate Mortgage	2,087	614	7,225	9,926	187,439	197,365	—
RE Construction and Development Loans	—	—	220	220	86,784	87,004	—
Agricultural Loans	—	—	—	—	30,932	30,932	—
Consumer Loans	—	—	—	—	9,086	9,086	—
Overdraft protection Lines	—	—	—	—	87	87	—

Overdrafts	—	—	—	—	157	157	—
Total Installment	—	—	—	—	9,330	9,330	—
Total Loans	$2,087	$708	$7,445	$10,240	$385,077	$395,317	$—

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Nonaccrual Loans

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

- When there is doubt regarding the full repayment of interest and principal.
- When principal and/or interest on the loan has been in default for a period of 90-days or more, unless the asset is both well secured and in the process of collection that will result in repayment in the near future.
- When the loan is identified as having loss elements and/or is risk rated "8" Doubtful.

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

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

All other loans where principal or interest is due and unpaid for 90 days or more are placed on non-accrual and the accrual of interest for financial statement purposes is discontinued. Previously accrued but unpaid interest is reversed and charged against interest income.

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

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

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

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

Nonaccrual loans totaled $9,935,000 and $12,341,000 at December 31, 2014 and 2013, respectively. There were no remaining undisbursed commitments to extend credit on nonaccrual loans at December 31, 2014 and 2013.

The following is a summary of nonaccrual loan balances at December 31, 2014 and 2013 (in thousands).

	December 31, 2014	December 31, 2013
Commercial and Business Loans	$12	$—
Government Program Loans	421	—
Total Commercial and Industrial	433	—
Commercial Real Estate Loans	3,145	10,188
Residential Mortgages	1,174	1,685
Home Improvement and Home Equity Loans	42	—

Total Real Estate Mortgage	4,361	11,873
RE Construction and Development Loans	5,141	468
Agricultural Loans	—	—
Consumer Loans	—	—
Total Installment	—	—
Total Loans	$9,935	$12,341

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Impaired Loans

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

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

A loan is not considered impaired if there is merely an insignificant delay or shortfall in the amounts of payments and the Company expects to collect all amounts due, including interest accrued, at the contractual interest rate for the period of the delay.

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

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

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

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

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

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

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

The following is a summary of impaired loans at December 31, 2014 (in thousands).

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December 31, 2014	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment	Interest Recognized
Commercial and Business Loans	$996	$770	$230	$1,000	$64	$847	$76
Government Program Loans	421	421	—	421	—	250	28
Total Commercial and Industrial	1,417	1,191	230	1,421	64	1,097	104
Commercial Real Estate Loans	3,145	1,794	1,351	3,145	478	5,765	244
Residential Mortgages	4,315	1,474	2,852	4,326	170	4,564	188
Home Improvement and Home Equity Loans	42	42	—	42	—	11	3
Total Real Estate Mortgage	7,502	3,310	4,203	7,513	648	10,340	435
RE Construction and Development Loans	6,367	6,371	—	6,371	—	3,362	209
Agricultural Loans	32	32	—	32	—	37	9
Consumer Loans	695	655	45	700	3	209	37
Total Installment	695	655	45	700	3	209	37
Total Impaired Loans	$16,013	$11,559	$4,478	$16,037	$715	$15,045	$794

The following is a summary of impaired loans at December 31, 2013 (in thousands).

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December 31, 2013	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment	Interest Recognized
Commercial and Business Loans	$675	$275	$402	$677	$9	$831	$52
Government Program Loans	—	—	—	—	—	35	—
Total Commercial and Industrial	675	275	402	677	9	866	52
Commercial Real Estate Loans	10,188	8,721	1,468	10,189	415	10,671	232
Residential Mortgages	5,375	1,794	3,590	5,384	338	6,139	211
Home Improvement and Home Equity Loans	—	—	—	—	—	13	—
Total Real Estate Mortgage	15,563	10,515	5,058	15,573	753	16,823	443
RE Construction and Development Loans	1,772	1,789	—	1,789	—	2,266	60
Agricultural Loans	44	45	—	45	—	84	10
Consumer Loans	48	48	—	48	—	72	4
Total Installment	48	48	—	48	—	72	4
Total Impaired Loans	$18,102	$12,672	$5,460	$18,132	$762	$20,111	$569

In most cases, the Company uses the cash basis method of income recognition for impaired loans. In the case of certain troubled debt restructuring for which the loan is performing under the current contractual terms for a reasonable period of time, income is recognized under the accrual method.

Troubled Debt Restructurings

Under the circumstances, when the Company grants a concession to a borrower as part of a loan restructuring, the restructuring is accounted for as a troubled debt restructuring (TDR). TDRs are reported as a component of impaired loans.

A TDR is a type of restructuring in which the Company, for economic or legal reasons related to the borrower's financial difficulties, grants a concession (either imposed by court order, law, or agreement between the borrower and the Bank) to the borrower that it would not otherwise consider. Although the restructuring may take different forms, the Company's objective is to maximize recovery of its investment by granting relief to the borrower.
A TDR may include, but is not limited to, one or more of the following:

- A transfer from the borrower to the Company of receivables from third parties, real estate, other assets, or an equity interest in the borrower is granted to fully or partially satisfy the loan.

- A modification of terms of a debt such as one or a combination of:

The reduction (absolute or contingent) of the stated interest rate.
The extension of the maturity date or dates at a stated interest rate lower than the current market rate for new debt with similar risk.
The reduction (absolute or contingent) of the face amount or maturity amount of debt as stated in the instrument or agreement.
The reduction (absolute or contingent) of accrued interest.

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For a restructured loan to return to accrual status there needs to be, among other factors, at least 6 months successful payment history. In addition, the Company performs a financial analysis of the credit to determine whether the borrower has the ability to continue to meet payments over the remaining life of the loan. This includes, but is not limited to, a review of financial statements and cash flow analysis of the borrower. Only after determination that the borrower has the ability to perform under the terms of the loans, will the restructured credit be considered for accrual status. Although the Company does not have a policy which specifically addresses when a loan may be removed from TDR classification, as a matter of practice, loans classified as TDRs generally remain classified as such until the loan either reaches maturity or its outstanding balance is paid off.

The following tables illustrate TDR activity for the periods indicated (dollars in thousands):

	Twelve Months Ended December 31, 2014				
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Contracts in Default	Recorded Investment on Defaulted TDRs
Troubled Debt Restructurings					
Commercial and Business Loans	5	$456	$437	1	$—
Government Program Loans	1	544	539	2	421
Commercial Real Estate Term Loans	2	1,948	1,362	—	—
Single Family Residential Loans	—	—	—	3	656
Home Improvement and Home Equity Loans	—	—	—	—	—
RE Construction and Development Loans	2	5,665	5,548	2	394
Agricultural Loans	—	—	—	—	—
Consumer Loans	1	630	650	—	—
Overdraft protection Lines	—	—	—	—	—
Total Loans	11	$9,243	$8,536	8	$1,471

	Twelve Months Ended December 31, 2013				
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Contracts in Default	Recorded Investment on Defaulted TDRs
Troubled Debt Restructurings					
Commercial and Business Loans	—	$—	$—	—	$—
Government Program Loans	—	—	—	—	—
Commercial Real Estate Term Loans	—	—	—	1	106
Single Family Residential Loans	—	—	—	—	—
Home Improvement and Home Equity Loans	1	44	44	—	—
RE Construction and Development Loans	47	4,399	4,399	—	—
Agricultural Loans	—	—	—	—	—
Consumer Loans	1	48	48	—	—
Overdraft protection Lines	—	—	—	—	—
Total Loans	49	$4,491	$4,491	1	$106

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The following tables summarize TDR activity by loan category for the years ended December 31, 2014 and 2013 (in thousands).

Twelve Months Ended December 31, 2014	Commercial and Industrial	Commercial Real Estate	Residential Mortgages	Home Equity	RE Construction Development	Agricultural	Installment & Other	Total
Beginning balance	$675	$1,468	$5,273	$—	$ 1,551	$44	$48	$9,059
Defaults	(421)	—	(656)	—	(394)	—	—	(1,471)
Additions	1,000	1,948	—	—	5,665	—	630	9,243
Principal advances (reductions)	52	(703)	(392)	—	(793)	(12)	17	(1,831)
Ending balance	$1,306	$2,713	$4,225	$—	$ 6,029	$32	$695	$15,000
Allowance for loan loss	$64	$478	$170	$—	$ —	$—	$3	$715

Twelve Months Ended December 31, 2013	Commercial and Industrial	Commercial Real Estate	Residential Mortgages	Home Equity	RE Construction Development	Agricultural	Installment & Other	Total
Beginning balance	$990	$5,395	$7,289	$10	$ 2,860	$191	$38	$16,773
Defaults	—	(106)	—	—	—	—	—	(106)
Additions	—	—	—	44	4,399	—	48	4,491
Principal reductions	(315)	(3,821)	(2,016)	(54)	(5,708)	(147)	(38)	(12,099)
Ending balance	$675	$1,468	$5,273	$—	$ 1,551	$44	$48	$9,059
Allowance for loan loss	$9	$415	$338	$—	$ —	$—	$—	$762

The Company makes various types of concessions when structuring TDR's including rate reductions, payment extensions, and forbearance. At December 31, 2014, the Company had 33 restructured loans totaling $15,000,000, as compared to 35 restructured loans totaling $9,059,000 at December 31, 2013.

Credit Quality Indicators

As part of its credit monitoring program, the Company utilizes a risk rating system which quantifies the risk the Company estimates it has assumed during the life of a loan. The system rates the strength of the borrower and the facility or transaction, and is designed to provide a program for risk management and early detection of problems.

For each new credit approval, credit extension, renewal, or modification of existing credit facilities, the Company assigns risk ratings utilizing the rating scale identified in this policy. In addition, on an on-going basis, loans and credit facilities are reviewed for internal and external influences impacting the credit facility that would warrant a change in the risk rating. Each loan credit facility is to be given a risk rating that takes into account factors that materially affect credit quality.

When assigning risk ratings, the Company evaluates two risk rating approaches, a facility rating and a borrower rating as follows.

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Facility Rating:

The facility rating is determined by the analysis of positive and negative factors that may indicate that the quality of a particular loan or credit arrangement requires that it be rated differently from the risk rating assigned to the borrower. The Company assesses the risk impact of these factors:

Collateral - The rating may be affected by the type and quality of the collateral, the degree of coverage, the economic life of the collateral, liquidation value and the Company's ability to dispose of the collateral.

Guarantees - The value of third party support arrangements varies widely. Unconditional guaranties from persons with demonstrable ability to perform are more substantial than that of closely related persons to the borrower who offer only modest support.

Unusual Terms - Credit may be extended on terms that subject the Company to a higher level of risk than indicated in the rating of the borrower.

Borrower Rating:

The borrower rating is a measure of loss possibility based on the historical, current and anticipated financial characteristics of the borrower in the current risk environment. To determine the rating, the Company considers at least the following factors:

- Quality of management
- Liquidity
- Leverage/capitalization
- Profit margins/earnings trend
- Adequacy of financial records
- Alternative funding sources
- Geographic risk
- Industry risk
- Cash flow risk
- Accounting practices
- Asset protection
- Extraordinary risks

The Company assigns risk ratings to loans other than consumer loans and other homogeneous loan pools based on the following scale. The risk ratings are used when determining borrower ratings as well as facility ratings. When the borrower rating and the facility ratings differ, the lowest rating applied is:

- Grades 1 and 2 – These grades include loans which are given to high quality borrowers with high credit quality and sound financial strength. Key financial ratios are generally above industry averages and the borrower’s strong earnings history or net worth. These may be secured by deposit accounts or high-grade investment securities.

- Grade 3 – This grade includes loans to borrowers with solid credit quality with minimal risk. The borrower’s balance sheet and financial ratios are generally in line with industry averages, and the borrower has historically demonstrated the ability to manage economic adversity. Real estate and asset-based loans assigned this risk rating must have characteristics, which place them well above the minimum underwriting requirements for those departments. Asset-based borrowers assigned this rating must exhibit extremely favorable leverage and cash flow characteristics, and consistently demonstrate a high level of unused borrowing capacity.

Grades 4 and 5 – These include "pass" grade loans to borrowers of acceptable credit quality and risk. The borrower's balance sheet and financial ratios may be below industry averages, but above the lowest industry quartile. Leverage is above and liquidity is below industry averages. Inadequacies evident in financial performance and/or management sufficiency are offset by readily available features of support, such as adequate collateral, or good guarantors having the liquid assets and/or cash flow capacity to repay the debt. The borrower may have recognized a loss over three or four years, however recent earnings trends, while perhaps somewhat cyclical, are improving and cash flows are adequate to cover debt service and fixed obligations. Real estate and asset-borrowers fully comply with all underwriting standards and are performing according to projections would be assigned this rating. These also include grade 5 loans which are "leveraged" or on management's "watch list." While still considered pass loans (loans given a grade 5), the borrower's financial condition, cash flow or operations evidence more than average risk and short term

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weaknesses, these loans warrant a higher than average level of monitoring, supervision and attention from the Company, but do not reflect credit weakness trends that weaken or inadequately protect the Company's credit position. Loans with a grade rating of 5 are not normally acceptable as new credits unless they are adequately secured or carry substantial endorser/guarantors.

- Grade 6 – This grade includes "special mention" loans which are loans that are currently protected but are potentially weak. This generally is an interim grade classification and should usually be upgraded to an Acceptable rating or downgraded to Substandard within a reasonable time period. Weaknesses in special mention loans may, if not checked or corrected, weaken the asset or inadequately protect the Company's credit position at some future date. Special mention loans are often loans with weaknesses inherent from the loan origination, loan servicing, and perhaps some technical deficiencies. The main theme in special mention credits is the distinct probability that the classification will deteriorate to a more adverse class if the noted deficiencies are not addressed by the loan officer or loan management.

- Grade 7 – This grade includes "substandard" loans which are inadequately supported by the current sound net worth and paying capacity of the borrower or of the collateral pledged, if any. Substandard loans have a well-defined weakness or weaknesses that may impair the regular liquidation of the debt. Substandard loans exhibit a distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. Substandard loans also include impaired loans.

- Grade 8 - This grade includes "doubtful" loans which exhibit the same characteristics as the Substandard loans with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. The possibility of loss is extremely high, but because of certain important and reasonably specific pending factors, which may work to the advantage and strengthening of the loan, its classification as an estimated loss is deferred until its more exact status may be determined. Pending factors include a proposed merger, acquisition, or liquidation procedures, capital injection, perfecting liens on additional collateral and refinancing plans.

- Grade 9 - This grade includes loans classified "loss" which are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off the asset even though partial recovery may be achieved in the future.

The following tables summarize the credit risk ratings for commercial, construction, and other non-consumer related loans for December 31, 2014 and 2013. The Company did not carry any loans graded as loss at December 31, 2014 and 2013.

December 31, 2014 (In thousands)	Commercial and Industrial	Commercial RE	RE Construction and Development	Agricultural	Total
Grades 1 and 2	$591	$—	$—	$—	$591
Grade 3	2,012	4,808	775	—	7,595
Grades 4 and 5 – pass	58,179	144,230	114,766	31,600	348,775
Grade 6 – special mention	342	1,095	—	113	1,550
Grade 7 – substandard	1,245	4,539	21,617	—	27,401
Grade 8 – doubtful	—	—	—	—	—
Total	$62,369	$154,672	$137,158	$31,713	$385,912

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December 31, 2013 (In thousands)	Commercial and Industrial	Commercial RE	RE Construction and Development	Agricultural	Total
Grades 1and 2	$355	$—	$—	$70	$425
Grade 3	44	5,287	816	—	6,147
Grades 4 and 5 – pass	69,070	127,189	66,048	30,862	293,169
Grade 6 – special mention	590	—	—	—	590
Grade 7 – substandard	627	11,443	20,140	—	32,210
Grade 8 – doubtful	—	—	—	—	—
Total	$70,686	$143,919	$87,004	$30,932	$332,541

The Company follows consistent underwriting standards outlined in its loan policy for consumer and other homogeneous loans but, does not specifically assign a risk rating when these loans are originated. Consumer loans are monitored for credit risk and are considered "pass" loans until some issue or event requires that the credit be downgraded to special mention or worse.
The following tables summarize the credit risk ratings for consumer related loans and other homogeneous loans for December 31, 2014 and 2013 (in thousands).

	December 31, 2014				December 31, 2013			
	Residential Mortgages	Home Improvement and Home Equity	Installment	Total	Residential Mortgages	Home Improvement and Home Equity	Installment	Total
Not graded	$38,207	$1,038	$10,287	$49,532	$29,063	$1,378	$7,862	$38,303
Pass	17,887	30	865	18,782	19,320	—	1,468	20,788
Special Mention	216	—	—	216	1,204	32	—	1,236
Substandard	2,785	42	650	3,477	2,449	—	—	2,449
Total	$59,095	$1,110	$11,802	$72,007	$52,036	$1,410	$9,330	$62,776

Allowance for Loan Losses

The Company analyzes risk characteristics inherent in each loan portfolio segment as part of the quarterly review of the adequacy of the allowance for loan losses. The following summarizes some of the key risk characteristics for the eleven segments of the loan portfolio (Consumer loans include three segments):

Commercial and business loans – Commercial loans are subject to the effects of economic cycles and tend to exhibit increased risk as economic conditions deteriorate, or if the economic downturn is prolonged. The Company considers this segment to be one of higher risk given the size of individual loans and the balances in the overall portfolio.

Government program loans – This is a relatively a small part of the Company's loan portfolio, but has historically had a high percentage of loans that have migrated from pass to substandard given there vulnerability to economic cycles.

Commercial real estate loans – This segment is considered to have more risk in part because of the vulnerability of commercial businesses to economic cycles as well as the exposure to fluctuations in real estate prices because most of these loans are secured by real estate. Losses in this segment have however been historically low because most of the loans are real estate secured.

Residential mortgages – This segment is considered to have low risk factors both from the Company and peer statistics. These loans are secured by first deeds of trust. The losses experienced over the past twelve quarters are isolated to approximately twelve loans and are generally the result of short sales.

Home improvement and home equity loans – Because of their junior lien position, these loans have an inherently higher risk level. Because residential real estate has been severely distressed in the recent past, the anticipated risk for this loan segment has increased.

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Real estate construction and development loans –In a normal economy, this segment of loans is considered to have a higher risk profile due to construction and market value issues in conjunction with normal credit risks. In the current distressed residential real estate markets the risk has increased.

Agricultural loans – This segment is considered to have risks associated with weather, insects, and marketing issues. In addition, concentrations in certain crops or certain agricultural areas can increase risk.

Installment loans (Includes consumer loans, overdrafts, and overdraft protection lines) – This segment is higher risk because many of the loans are unsecured.

Commercial lease financing – This segment of the portfolio is small, but is considered to be vulnerable to economic cycles given the nature of the leasing relationship where businesses are relatively small or have minimal cash flow. This lending program was terminated in 2005.

The following summarizes the activity in the allowance for credit losses by loan category for the years ended December 31, 2014 and 2013 (in thousands).

December 31, 2014	Commercial and Industrial	Real Estate Mortgage	RE Construction Development	Agricultural	Installment & Other	Commercial Lease Financing	Unallocated	Total
Beginning balance	$2,340	$1,862	$5,533	$583	$275	$—	$395	$10,988
Provision for credit losses	(1,129)	(89)	97	(106)	(40)	(46)	468	(845)
Charge-offs	(318)	(140)	(60)	0	—	—	(16)	(534)
Recoveries	325	20	708	5	58	46	—	1,162
Net recoveries(charge-offs)	7	(120)	648	5	58	46	(16)	628
Ending balance	$1,218	$1,653	$6,278	$482	$293	$—	$847	$10,771
Period-end amount allocated to:								
Loans individually evaluated for impairment	64	648	—	—	3	—	—	715
Loans collectively evaluated for impairment	1,154	1,005	6,278	482	290	—	847	10,056
Ending balance	$1,218	$1,653	$6,278	$482	$293	$—	$847	$10,771

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December 31, 2013	Commercial and Industrial	Real Estate Mortgage	RE Construction Development	Agricultural	Installment & Other	Commercial Lease Financing	Unallocated	Total
Beginning balance	$1,614	$1,292	$2,814	$352	$288	$1	$5,423	$11,784
Provision for credit losses	1,134	1,101	1,285	222	160	(1)	(4,999)	(1,098)
Charge-offs	(542)	(540)	(95)	(136)	(244)	—	(29)	(1,586)
Recoveries	134	9	1,529	145	71	—	—	1,888
Net recoveries (charge-offs)	(408)	(531)	1,434	9	(173)	—	(29)	302
Ending balance	$2,340	$1,862	$5,533	$583	$275	$—	$395	$10,988
Period-end amount allocated to:								
Loans individually evaluated for impairment	9	753	—	—	—	—	—	762
Loans collectively evaluated for impairment	2,331	1,109	5,533	583	275	—	395	10,226
Ending balance	$2,340	$1,862	$5,533	$583	$275	$—	$395	$10,988

The following summarizes information with respect to the loan balances at December 31, 2014 and 2013.

(In thousands)	December 31, 2014 Loans Individually Evaluated for Impairment	December 31, 2014 Loans Collectively Evaluated for Impairment	December 31, 2014 Total Loans	December 31, 2013 Loans Individually Evaluated for Impairment	December 31, 2013 Loans Collectively Evaluated for Impairment	December 31, 2013 Total Loans
Commercial and Business Loans	$1,000	$59,422	$60,422	$677	$67,783	$68,460
Government Program Loans	421	1,526	1,947	—	2,226	2,226
Total Commercial and Industrial	1,421	60,948	62,369	677	70,009	70,686
Commercial Real Estate Loans	3,145	151,527	154,672	10,189	133,730	143,919
Residential Mortgage Loans	4,326	54,769	59,095	5,384	46,652	52,036
Home Improvement and Home Equity Loans	42	1,068	1,110	—	1,410	1,410
Total Real Estate Mortgage	7,513	207,364	214,877	15,573	181,792	197,365
	6,371	130,787	137,158	1,789	85,215	87,004

RE Construction and Development Loans						
Agricultural Loans	32	31,681	31,713	45	30,887	30,932
Installment Loans	700	11,102	11,802	48	9,282	9,330
Total Loans	$16,037	$441,882	$457,919	$18,132	$377,185	$395,317

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4. Premises and Equipment

The components of premises and equipment are as follows:

(In thousands)	December 31, 2014	December 31, 2013
Land	$968	$968
Buildings and improvements	14,731	14,613
Furniture and equipment	11,713	11,077
	27,412	26,658
Less accumulated depreciation and amortization	(15,862)	(14,536)
Total premises and equipment	$11,550	$12,122

Total depreciation expense on Company premises and equipment totaled $1,390,000 and $1,316,000 for the years ended December 31, 2014 and 2013, respectively, and is included in occupancy expense in the accompanying consolidated statements of operations.

5. Investment in Limited Partnership

The Bank owns limited interests in private limited partnerships that acquire affordable housing properties in California that generate Low Income Housing Tax Credits under Section 42 of the Internal Revenue Code of 1986, as amended. The Bank's limited partnership investment is accounted for under the equity method. The Bank's noninterest expense associated with the utilization and expiration of these tax credits for the years ended December 31, 2014 and 2013 was $39,000 and $253,000, respectively. These limited partnership investments are expected to generate tax credits of approximately $1.8 million over the life of the investment. The tax credits expire during 2015. No tax credits were available for income tax purposes for the years ended December 31, 2014 and 2013.

The Bank owns a 9.14% interest in a limited partnership which provides private capital for small to mid-sized businesses used to finance later stage growth, strategic acquisitions, ownership transitions, and recapitalizations, or mezzanine capital. The Company sold its $3,559,000 or 36% interest in a commercial real estate partnership in 2014 for a $691,000 gain on sale. At December 31, 2014, the total investment in limited partnerships was $871,000 .

6. Deposits

Deposits include the following:

(In thousands)	December 31, 2014	December 31, 2013
Noninterest-bearing deposits	$215,439	$214,317
Interest-bearing deposits:		
NOW and money market accounts	211,290	198,928
Savings accounts	60,499	45,758
Time deposits:		
Under $100,000	25,345	28,825
$100,000 and over	52,800	54,661
Total interest-bearing deposits	349,934	328,172
Total deposits	$565,373	$542,489

At December 31, 2014, the scheduled maturities of all certificates of deposit and other time deposits are as follows:

(In thousands)	December 31, 2014
One year or less	$64,972
More than one year, but less than or equal to two years	9,900
More than two years, but less than or equal to three years	1,993
More than three years, but less than or equal to four years	1,168
More than four years, but less than or equal to five years	112
More than five years	—
	$78,145

The Company may utilize brokered deposits as an additional source of funding. At December 31, 2014 and 2013, the Company held brokered time deposits totaling $11,480,000 and $11,500,000, respectively. Of this balance at December 31, 2014, $10,320,000 is included in time deposits of $250,000 or more, and the remaining $$1,160,000 is included in time deposits of less than $250,000. Included in brokered time deposits at December 31, 2014 are balances totaling $3,815,000 maturing in three months or less, $7,211,000 maturing in 3 months to a year, and the remaining $453,000 maturing in 1 to 3 years.

Deposit balances representing overdrafts reclassified as loan balances totaled $215,000 and $157,000 as of December 31, 2014 and 2013, respectively.

Deposits of directors, officers and other related parties to the Bank totaled $8,658,000 and $6,943,000 at December 31, 2014 and 2013, respectively. The rates paid on these deposits were similar to those customarily paid to the Bank’s customers in the normal course of business.

7. Short-term Borrowings/Other Borrowings

At December 31, 2014, the Company had collateralized lines of credit with the Federal Reserve Bank of San Francisco totaling $286,993,000, as well as Federal Home Loan Bank (“FHLB”) lines of credit totaling $5,814,000. At December 31, 2014, the Company had an uncollateralized line of credit with Pacific Coast Bankers Bank ("PCBB") totaling $10,000,000. At December 31, 2014, and for the year then ended, the Company had no outstanding borrowing balances. These lines of credit generally have interest rates tied to the Federal Funds rate or are indexed to short-term U.S. Treasury rates or LIBOR. FHLB advances are collateralized by all of the Company’s stock in the FHLB, investment securities, and certain qualifying mortgage loans. As of December 31, 2014, $6,106,000 in investment securities at FHLB were pledged as collateral for FHLB advances. Additionally, $406,358,000 in real estate-secured loans were pledged at December 31, 2014, as collateral for used and unused borrowing lines with the Federal Reserve Bank totaling $286,993,000. All lines of credit are on an “as available” basis and can be revoked by the grantor at any time.

The Company had collateralized lines of credit with the Federal Reserve Bank of San Francisco totaling $254,761,000, as well as Federal Home Loan Bank (“FHLB”) lines of credit totaling $7,094,000 at December 31, 2013. At December 31, 2013, and for the year then ended, the Company had no outstanding borrowing balances.

8. Junior Subordinated Debt/Trust Preferred Securities

During July 2007, the Company formed USB Capital Trust II, a wholly-owned special purpose entity, for the purpose of issuing Trust Preferred Securities. USB Capital Trust II is a Variable Interest Entity (VIE) and a deconsolidated entity pursuant to ASC 810. On July 23, 2007, USB Capital Trust II issued $15 million in Trust Preferred securities. The securities have a thirty-year maturity and bear a floating rate of interest (repricing quarterly) of 1.29% over the three-month LIBOR rate (initial coupon rate of 6.65%). Interest will be paid quarterly. Concurrent with the issuance of the Trust Preferred securities, USB Capital Trust II used the proceeds of the Trust Preferred securities offering to purchase a like amount of junior subordinated debentures of the Company. The Company will pay interest on the junior subordinated debentures to USB Capital Trust II, which represents the sole source of dividend distributions to the holders of the Trust Preferred securities. The Company may redeem the junior subordinated debentures at anytime at par.

The Company elected the fair value measurement option for all the Company’s new junior subordinated debentures issued under USB Capital Trust II.

Effective September 30, 2009 and beginning with the quarterly interest payment due October 1, 2009, the Company elected to defer interest payments on the Company’s $15.0 million of junior subordinated debentures relating to its trust preferred

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securities. The terms of the debentures and trust indentures allow for the Company to defer interest payments for up to 20 consecutive quarters without default or penalty. During the period that the interest deferrals were elected, the Company continued to record interest expense associated with the debentures. As of June 30, 2014, the Company ended the extension period, paid all accrued and unpaid interest, and is currently making quarterly interest payments. At December 31, 2014 and 2013, the Company had $58,000 and $1,172,000, respectively, in accrued and unpaid interest on the junior subordinated debt.

At December 31, 2014, as with previous periods, the Company performed a fair value measurement analysis on its junior subordinated debt using a discounted cash flow valuation model approach to determine the present value of those cash flows. The cash flow model utilizes the forward 3-month LIBOR curve to estimate future quarterly interest payments due over the life of the debt instrument. These cash flows were discounted at a rate which incorporates a current market rate for similar-term debt instruments, adjusted for additional credit and liquidity risks associated with the junior subordinated debt. Although there is little market data in the current relatively illiquid credit markets, we believe the 6.87% discount rate used represents what a market participant would consider under the circumstances based on current market assumptions.

The fair value calculation performed resulted in a realized losses of $102,000 and $776,000 for the years ended December 31, 2014 and 2013, respectively. Fair value gains and losses are reflected as a component of noninterest income.

9. Taxes on Income

The tax effects of significant items comprising the Company’s net deferred tax assets (liabilities) are as follows:

	December 31,	
(In thousands)	2014	2013
Deferred tax assets:		
Credit losses not currently deductible	$4,962	$4,927
Deferred compensation	1,976	1,920
Net operating losses	1,653	9,074
Depreciation	346	231
Accrued reserves	54	63
Write-down on other real estate owned	404	(97)
Unrealized gain on AFS	133	(211)
Interest on nonaccrual loans	43	36
Capitalized OREO expenses	778	1,079
Other	2,973	2,555
Total deferred tax assets	13,322	19,577
Deferred tax liabilities:		
State Tax	(1,681)	(2,640)
FHLB dividend	(53)	(53)
Loss on limited partnership investment	(1,077)	(1,808)
Deferred gain SFAS No. 159 – fair value option	(2,425)	(2,471)
Fair value adjustments for purchase accounting	(139)	(167)
Deferred loan costs	(750)	(570)
Prepaid expenses	(344)	(238)
Total deferred tax liabilities	(6,469)	(7,947)
Net deferred tax assets	$6,853	$11,630

The Company periodically evaluates its deferred tax assets to determine whether a valuation allowance is required based upon a determination that some or all of the deferred assets may not be ultimately realized. The Company did not record a valuation allowance at December 31, 2014 or December 31, 2013.

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Income tax expense (benefit) for the years ended December 31, consist of the following:

(In thousands)			
2014	Federal	State	Total
Current	$1,129	$(1,753)	$(624)
Deferred	1,994	2,822	4,816
	$3,123	$1,069	$4,192
2013			
Current	$1,059	$819	$1,878
Deferred	(1,055)	(718)	(1,773)
	$4	$101	$105

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A reconciliation of the statutory federal income tax rate to the effective income tax rate is as follows:

	Year Ended December 31,			
	2014		2013	
Statutory federal income tax rate	34.0	%	34.0	%
State franchise tax, net of federal income tax benefit	6.8		0.9	
Low Income Housing – federal credits	0.0		0.0	
Cash surrender value of life insurance	0.0		(2.4	)
Valuation Allowance	0.0		(33.0	)
Other	(0.5	)	1.9	
	40.3	%	1.4	%

During the year ended December 31, 2013, the Company reversed the remaining valuation allowance of $2,686,000. At December 31, 2014, the Company has no remaining federal net operating loss carry-forwards, and remaining state net operating loss carry-forwards totaling $27,404,000 which expire between 2015 and 2032. The Company anticipates that it will utilize the net operating loss carry-forwards expiring in 2015.

The Company periodically reviews its tax positions under the accounting standards related to uncertainty in income taxes, which defines the criteria that an individual tax position would have to meet for some or all of the income tax benefit to be recognized in a taxable entity's financial statements. Under the guidelines, an entity should recognize the financial statement benefit of a tax position if it determines that it is more likely than not that the position will be sustained on examination. The term, "more likely than not", means a likelihood of more than 50 percent. In assessing whether the more-likely-than-not criterion is met, the entity should assume that the tax position will be reviewed by the applicable taxing authority and all available information is known to the taxing authority.

The Company and its subsidiary file income tax returns in the U.S federal jurisdiction, and several states within the U.S. There are no filings in foreign jurisdictions. During 2014, the Company began the process to amend its state tax returns for the years 2009 through 2012 to file a combined report on a unitary basis with the Company and USB Investment Trust . The amended return for 2009 was filed during 2014 and the amended returns for 2010, 2011, and 2012 will be filed during 2015 once the FTB accepts the 2009 amended return.

The Company is not currently aware of any other tax jurisdictions where the Company or any subsidiary is subject to examination by federal, state, or local taxing authorities.

10. Stock Based Compensation

Options have been granted to officers and key employees at an exercise price equal to estimated fair value at the date of grant as determined by the Board of Directors. All options granted are service awards, and as such are based solely upon fulfilling a requisite service period (the vesting period). In May 2005, the Company's shareholders approved the adoption of the United Security Bancshares 2005 Stock Option Plan (2005 Plan). At the same time, all previous plans, including the 1995 Plan, were terminated. The 2005 Plan provides for the granting of up to 647,628 shares of authorized and unissued shares of common stock at option prices per share which must not be less than 100% of the fair market value per share at the time each option is granted.

The options granted (incentive stock options for employees and non-qualified stock options for Directors) have an exercise price at the prevailing market price on the date of grant. All options granted are exercisable 20% each year commencing one year after the date of grant and expire ten years after the date of grant.

Under the 2005 Plan, 142,562 granted shares are outstanding (111,402 incentive stock options and 31,160 nonqualified stock options) as of December 31, 2014, of which 114,375 are vested.

Options outstanding, exercisable, exercised and forfeited are as follows:

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	2005 Plan	Weighted Average Exercise Price
Options outstanding December 31, 2013	200,064	$10.19
Granted during the year	5,100	5.65
Exercised during the year	23,922	3.97
Forfeited during the year	38,680	13.99
Options outstanding December 31, 2014	142,562	$10.04

Included in total outstanding options at December 31, 2014, are 114,375 exercisable shares at a weighted average price of $11.48, a weighted average remaining contract term of 1.33 years and intrinsic value of $8,000.

Included in salaries and employee benefits for the years ended December 31, 2014 and 2013, is $28,000 and $29,000 of share-based compensation, respectively. The related tax benefit on share-based compensation recorded in the provision for income taxes was not material to either year.

As of December 31, 2014 and 2013, there was $85,000 and $64,000, respectively, of total unrecognized compensation expense related to non−vested stock options. This cost is expected to be recognized over a weighted average period of approximately 3.0 years. 5,202 options were exercised during 2013, while 23,922 options were exercised during 2014.

	December 31, 2014	December 31, 2013
Weighted average grant-date fair value of stock options granted	$3.33	$2.80
Total fair value of stock options vested	$31,440	$24,310
Total intrinsic value of stock options exercised	$39,711	$9,665

The Bank determines fair value at grant date using the Black-Scholes-Merton pricing model that takes into account the stock price at the grant date, the exercise price, the expected life of the option, the volatility of the underlying stock and the expected dividend yield and the risk-free interest rate over the expected life of the option.

The weighted average assumptions used in the pricing model are noted in the table below. The expected term of options granted is derived using the simplified method, which is based upon the average period between vesting term and expiration term of the options. The risk free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of the grant. Expected volatility is based on the historical volatility of the Bank's stock over a period commensurate with the expected term of the options. The Company believes that historical volatility is indicative of expectations about its future volatility over the expected term of the options.

The Bank expenses the fair value of the option on a straight-line basis over the vesting period for each separately vesting portion of the award. The Bank estimates forfeitures and only recognizes expense for those shares expected to vest. Based upon historical evidence, the Company has determined that because options are granted to a limited number of key employees rather than a broad segment of the employee base, expected forfeitures, if any, are not material. The Company granted 5,100 shares and 25,502 shares in incentive stock options during 2014 and 2013, respectively. The assumptions used for the 2014 and 2013 stock option grant are as follows:

	Year Ended December 31, 2014	Year Ended December 31, 2013
Risk Free Interest Rate	1.70%	1.20%
Expected Dividend Yield	—%	—%
Expected Life in Years	5.5 years	5.5 years
Expected Price Volatility	67.02%	78.88%

The Black-Scholes-Merton option valuation model requires the input of highly subjective assumptions, including the expected life of the stock based award and stock price volatility. The assumptions listed above represent management's best estimates, but these estimates involve inherent uncertainties and the application of management judgment. As a result, if other assumptions had been used, the Bank's recorded stock-based compensation expense could have been materially different from that previously reported in proforma disclosures. In addition, the Bank is required to estimate the expected forfeiture rate and only recognize expense for those shares expected to vest. If the Bank's actual forfeiture rate is materially different from the estimate, the share-based compensation expense could be materially different.

11. Employee Benefit Plans

401K Plan

The Company has a Cash or Deferred 401(k) Stock Ownership Plan (the "401(k) Plan") organized under Section 401(k) of the Code. All employees of the Company are initially eligible to participate in the 401(k) Plan upon the first day of the month after date of hire. Under the terms of the plan, the participants may elect to make contributions to the 401(k) Plan as determined by the Board of Directors. Participants are automatically vested 100% in all employee contributions. Participants may direct the investment of their contributions to the 401(k) Plan in any of several authorized investment vehicles. The Company contributes funds to the Plan up to 4% of the employees' eligible annual compensation. Company contributions are immediately 100% vested at the time of contribution. During 2014 and 2013, the Company made matching contributions of $239,000 and $256,000 to the 401(k) Plan, respectively.

Salary Continuation Plan

The Company has an unfunded, non-qualified Salary Continuation Plan for senior executive officers and certain other key officers of the Company, which provides additional compensation benefits upon retirement for a period of 15 years. Future compensation under the Plan is earned by the employees for services rendered through retirement and vests over a period of 12 to 15 years. The Company accrues for the salary continuation liability based on anticipated years of service and vesting schedules provided under the Plan. The Company's current benefit liability is determined based upon vesting and the present value of the benefits at a corresponding discount rate. The discount rate used is an equivalent rate for high-quality investment-grade bonds with lives matching those of the service periods remaining for the salary continuation contracts, which averages approximately 20 years. At December 31, 2014 and 2013, $4,135,000 and $4,031,000, respectively, had been accrued to date, based on a discounted cash flow using an average discount rate of 2.69% and 3.39%, respectively, and is included in other liabilities. In connection with the implementation of the Salary Continuation Plans, the Company purchased single premium universal life insurance policies on the life of each of the key employees covered under the Plan. The Company is the owner and beneficiary of these insurance policies. The cash surrender value of the policies was $5,826,000 and $4,421,000 at December 31, 2014 and 2013, respectively, and is included on the consolidated balance sheet in cash surrender value of life insurance. Income on these policies, net of expense, totaled approximately $1,405,000 and $124,000 for the years ended December 31, 2014 and 2013, respectively. Although the Plan is unfunded, the Company intends to utilize the proceeds of such policies to settle the Plan obligations. Under Internal Revenue Service regulations, the life insurance policies are the property of the Company and are available to satisfy the Company's general creditors.

Pursuant to the guidance contained in ASC Topic 715 "Compensation," the Company is required to recognize in accumulated other comprehensive (loss) income, the amounts that have not yet been recognized as components of net periodic benefit costs. These unrecognized costs arise from changes in estimated interest rates used in the calculation of net liabilities under the plan.

As of December 31, 2014 and 2013, the Company had approximately $502,000 and $436,000, respectively in unrecognized net periodic benefit costs arising from changes in interest rates used in calculating the current post-retirement liability required under the plan. This amount represents the difference between the plan liabilities calculated under net present value calculations, and the net plan liabilities actually recorded on the Company's books at

December 31, 2014 and 2013.

Salary continuation expense is included in salaries and benefits expense, and totaled $143,000 and $160,000 for the years ended December 31, 2014 and 2013, respectively.

Officer Supplemental Life Insurance Plan

The Company owns single premium Bank-owned life insurance policies (BOLI) on certain officers with a portion of the death benefits available to the officers' beneficiaries. The BOLI's initial net cash surrender value is equivalent to the premium paid, and it adds income through non-taxable increases in its cash surrender value, net of the cost of insurance, plus any death benefits ultimately received by the Company. The cash surrender value of these insurance policies totaled $11,891,000 and $12,782,000 at December 31, 2014 and 2013, and is included on the consolidated balance sheet in cash surrender value of life

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insurance. These policies resulted in a net expense of approximately $493,000 and income, net of expense, totaling $398,000 for the years ended December 31, 2014 and 2013, respectively.

12. Commitments and Contingent Liabilities

Lease Commitments: The Company leases land and premises for its branch banking offices and administration facilities. The initial terms of these leases expire at various dates through 2023. Under the provisions of most of these leases, the Company has the option to extend the leases beyond their original terms at rental rates adjusted for changes reported in certain economic indices or as reflected by market conditions. The total expense on land and premises leased under operating leases was $718,000 and $652,000 during 2014 and 2013, respectively. Total rent expense for the years ended December 31, 2014 and 2013 included approximately $23,000 and $18,000 in reductions, respectively, related to adjustments made pursuant to ASC Topic 840, "Leases". The adjustments represent the difference between contractual rent amounts paid and rent amounts actually expensed under the straight-line method pursuant to ASC 840.

Future minimum rental commitments under existing non-cancelable leases as of December 31, 2014 are as follows:

(In thousands):	
2015	$562
2016	415
2017	379
2018	375
2019	192
Thereafter	193
	$2,116

Financial Instruments with Off-Balance Sheet Risk: The Company is party to financial instruments with off-balance sheet risk which arise in the normal course of business. These instruments may contain elements of credit risk, interest rate risk and liquidity risk, and include commitments to extend credit and standby letters of credit. The credit risk associated with these instruments is essentially the same as that involved in extending credit to customers and is represented by the contractual amount indicated in the table below:

	Contractual amount – December 31,	
(In thousands)	2014	2013
Commitments to extend credit	$105,434	$63,271
Standby letters of credit	3,800	2,001

Commitments to extend credit are agreements to lend to a customer, as long as there is no violation of any condition established in the contract. Substantially all of these commitments are at floating interest rates based on the Prime rate, and most have fixed expiration dates. The Company evaluates each customer's creditworthiness on a case-by-case basis, and the amount of collateral obtained, if deemed necessary, is based on management's credit evaluation. Collateral held varies but includes accounts receivable, inventory, leases, property, plant and equipment, residential real estate and income-producing properties. Many of the commitments are expected to expire without being drawn upon and, as a result, the total commitment amounts do not necessarily represent future cash requirements of the Company.

Standby letters of credit are generally unsecured and are issued by the Company to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers. The Company's letters of credit are short-term guarantees and generally have terms from less than one month to approximately 3 years. At December 31, 2014, the maximum potential amount of future undiscounted payments the Company could be required to make under outstanding standby letters of credit totaled $3,800,000.

In the ordinary course of business, the Company becomes involved in litigation arising out of its normal business activities. Management, after consultation with legal counsel, believes that the ultimate liability, if any, resulting from the disposition of such claims would not be material to the financial position of the Company.

13. Fair Value Measurements and Disclosure

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The following summary disclosures are made in accordance with the guidance provided by ASC Topic 825 “Fair Value Measurements and Disclosures” (formerly Statement of Financial Accounting Standards No. 107, “Disclosures about Fair Value of Financial Instruments,”) which requires the disclosure of fair value information about both on- and off-balance sheet financial instruments where it is practicable to estimate that value.

Generally accepted accounting guidance clarifies the definition of fair value, describes methods used to appropriately measure fair value in accordance with generally accepted accounting principles and expands fair value disclosure requirements. This guidance applies whenever other accounting pronouncements require or permit fair value measurements.

The fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value into three broad levels (Level 1, Level 2, and Level 3). Level 1 inputs are unadjusted quoted prices in active markets (as defined) for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. Level 3 inputs are unobservable inputs for the asset or liability, and reflect the reporting entity’s own assumptions about the assumptions that market participants would use in pricing the asset or liability (including assumptions about risk).

The table below is a summary of fair value estimates for financial instruments and the level of the fair value hierarchy within which the fair value measurements are categorized at the periods indicated:
December 31, 2014

(In thousands)	Carrying Amount	Estimated Fair Value	Quoted Prices In Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
Financial Assets:					
Cash and cash equivalents	$103,577	$103,577	$103,577	$—	$—
Interest-bearing deposits	1,522	1,522	—	1,522	—
Investment securities	48,301	48,301	3,823	44,478	—
Loans	446,824	441,186	—	—	441,186
Accrued interest receivable	1,927	1,927	—	1,927	—
Financial Liabilities:					
Deposits:					
Noninterest-bearing	215,439	215,439	215,439	—	—
NOW and money market	211,290	211,290	211,290	—	—
Savings	60,499	60,499	60,499	—	—
Time Deposits	78,145	78,239	—	—	78,239
Total Deposits	565,373	565,467	487,228	—	78,239
Junior Subordinated Debt	10,115	10,115	—	—	10,115
Accrued interest payable	40	40	—	40	—

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December 31, 2013

(In thousands)	Carrying Amount	Estimated Fair Value	Quoted Prices In Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
Financial Assets:					
Cash and cash equivalents	$135,212	$135,212	$135,212	$—	$—
Interest-bearing deposits	1,515	1,515	—	1,515	—
Investment securities	43,616	43,616	10,746	32,870	—
Loans	384,025	380,615	—	—	380,615
Accrued interest receivable	1,644	1,644	—	1,644	—
Financial Liabilities:					
Deposits:					
Noninterest-bearing	214,317	214,317	214,317	—	—
NOW and money market	198,928	198,928	198,928	—	—
Savings	45,758	45,758	45,758	—	—
Time Deposits	83,486	83,362	—	—	83,362
Total Deposits	542,489	542,365	459,003	—	83,362
Junior Subordinated Debt	11,125	11,125	—	—	11,125
Accrued interest payable	44	44	—	44	—

The Company performs fair value measurements on certain assets and liabilities as the result of the application of current accounting guidelines. Some fair value measurements, such as available-for-sale securities (AFS) and junior subordinated debt are performed on a recurring basis, while others, such as impairment of loans, other real estate owned, goodwill and other intangibles, are performed on a nonrecurring basis.

The following tables summarize the Company's assets and liabilities that were measured at fair value on a recurring and non-recurring basis as of December 31, 2014 (in 000's):

Description of Assets	December 31, 2014	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
AFS Securities (2):				
U.S. Government agencies	$12,496	$—	$12,495	$—
U.S Govt collateralized mortgage obligations	31,982	—	31,983	—
Mutual Funds	3,823	3,823	—	—
Total AFS securities	48,301	3,823	44,478	—
Impaired Loans (1):				
Commercial and industrial	—	—	—	—
Real estate mortgage	42	—	—	42
RE construction & development	—	—	—	—
Agricultural	—	—	—	—
Installment/Other	—	—	—	—
Total impaired loans	42	—	—	42

Other real estate owned (1)	—	—	—	—
Total	$48,343	$3,823	$44,478	$42

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Description of Liabilities	December 31, 2014	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Junior subordinated debt (2)	$ 10,115	$—	$—	$10,115
Total	$ 10,115	$—	$—	$10,115

(1)Nonrecurring
(2)Recurring

The following tables summarize the Company's assets and liabilities that were measured at fair value on a recurring and non-recurring basis as of December 31, 2013 (in 000's):

Description of Assets	December 31, 2013	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
AFS Securities (2):				
U.S. Government agencies	$ 14,501	$—	$14,501	$—
U.S Govt collateralized mortgage obligations	25,385	7,016	18,369	—
Mutual Funds	3,730	3,730	—	—
Total AFS securities	43,616	10,746	32,870	—
Impaired Loans (1):				
Commercial and industrial	—	—	—	—
Real estate mortgage	1,388	—	—	1,388
RE construction & development	—	—	—	—
Agricultural	—	—	—	—
Installment/Other	—	—	—	—
Total impaired loans	1,388	—	—	1,388
Other real estate owned (1)	3,889	—	—	3,889
Total	$ 48,893	$10,746	$32,870	$5,277

Description of Liabilities	December 31, 2013	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Junior subordinated debt (2)	$11,125	$—	$—	$11,125
Total	$11,125	$—	$—	$11,125

(1)Nonrecurring
(2)Recurring

The following table presents quantitative information about Level 3 fair value measurements for the Company's assets measured at fair value on a non-recurring basis at December 31, 2014:

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December 31, 2014

Financial Instrument	Fair Value	Valuation Technique	Unobservable Input	Range, Weighted Average
Impaired Loans:				
Real estate mortgage	$42	Sales Comparison Approach	Adjustment for difference between comparable sales	1%-16%, 13.2%

The following methods and assumptions were used in estimating the fair values of financial instruments:

Cash and Cash Equivalents - The carrying amounts reported in the balance sheets for cash and cash equivalents approximate their estimated fair values.

Interest-bearing Deposits – Interest bearing deposits in other banks consist of fixed-rate certificates of deposits. Accordingly, fair value has been estimated based upon interest rates currently being offered on deposits with similar characteristics and maturities.

Investments – Available for sale securities are valued based upon open-market price quotes obtained from reputable third-party brokers that actively make a market in those securities. Market pricing is based upon specific CUSIP identification for each individual security. To the extent there are observable prices in the market, the mid-point of the bid/ask price is used to determine fair value of individual securities. If that data is not available for the last 30 days, a Level 2-type matrix pricing approach based on comparable securities in the market is utilized. Level-2 pricing may include using a forward spread from the last observable trade or may use a proxy bond like a TBA mortgage to come up with a price for the security being valued. Changes in fair market value are recorded through other comprehensive loss as the securities are available for sale.

Loans - Fair values of variable rate loans, which reprice frequently and with no significant change in credit risk, are based on carrying values adjusted for credit risk. Fair values for all other loans, except impaired loans, are estimated using discounted cash flows over their remaining maturities, using interest rates at which similar loans would currently be offered to borrowers with similar credit ratings and for the same remaining maturities.

Impaired Loans - Fair value measurements for impaired loans are performed pursuant to authoritative accounting guidance and are based upon either collateral values supported by appraisals, observed market prices, or discounted cash flows. Changes are not recorded directly as an adjustment to current earnings or comprehensive income, but rather as an adjustment component in determining the overall adequacy of the loan loss reserve. Such adjustments to the estimated fair value of impaired loans may result in increases or decreases to the provision for credit losses recorded in current earnings. Collateral dependent loans are measured for impairment using the fair value of the collateral.

Other Real Estate Owned - Nonrecurring adjustments to certain commercial and residential real estate properties classified as other real estate owned (OREO) are measured at the lower of carrying amount or fair value, less costs to sell. Fair values are generally based on third party appraisals of the property, resulting in a Level 3 classification. In cases where the carrying amount exceeds the fair value, less costs to sell, an impairment loss is recognized.

Deposits – In accordance with authoritative accounting guidance, fair values for transaction and savings accounts are equal to the respective amounts payable on demand at December 31, 2014 and 2013 (i.e., carrying amounts). The Company believes that the fair value of these deposits is clearly greater than that prescribed under authoritative accounting guidance. Fair values of fixed-maturity certificates of deposit were estimated using the rates currently offered for deposits with similar remaining maturities.

Junior Subordinated Debt – The fair value of the junior subordinated debt was determined based upon a discounted cash flows model utilizing observable market rates and credit characteristics for similar debt instruments. In its analysis, the Company used characteristics that market participants generally use, and considered factors specific to (a) the liability, (b) the principal (or most advantageous) market for the liability, and (c) market participants with whom the reporting entity would transact in that market. For the year ended December 31, 2014, cash flows were discounted at a rate which incorporates a current market rate for similar-term debt instruments, adjusted for credit and liquidity risks associated with similar junior subordinated debt and circumstances unique to the Company. The Company believes that the subjective nature of theses inputs, due primarily to the current economic environment, require the junior subordinated debt to be classified as a Level 3 fair value.

Accrued Interest Receivable and Payable - The carrying value of these instruments is a reasonable estimate of fair value.

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Off-balance sheet Instruments - Off-balance sheet instruments consist of commitments to extend credit, standby letters of credit and derivative contracts. The contract amounts of commitments to extend credit and standby letters of credit are disclosed in Note 12. Fair values of commitments to extend credit are estimated using the interest rate currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present counterparties' credit standing. There was no material difference between the contractual amount and the estimated value of commitments to extend credit at December 31, 2014 and 2013.

Fair values of standby letters of credit are based on fees currently charged for similar agreements. The fair value of commitments generally approximates the fees received from the customer for issuing such commitments. These fees are not material to the Company's consolidated balance sheet and results of operations.

The following tables provide a reconciliation of liabilities at fair value using significant unobservable inputs (Level 3) on a recurring basis during the period (in 000's):

Reconciliation of Liabilities:	December 31, 2014 Junior Subordinated Debt	December 31, 2013 Junior Subordinated Debt
Beginning balance	$11,125	$10,068
Total gains (losses) included in earnings (or changes in net assets)	(102)	(776)
Transfers in and/or out of Level 3 resulting from changes in unobservable input	(908)	281
Ending balance	$10,115	$9,573
The amount of total gains (losses) for the period included in earnings (or changes in net assets) attributable to the change in unrealized gains or losses and accrued interest relating to liabilities still held at the reporting date	$(102)	$(776)

The following table provides a description of the valuation technique, unobservable input, and qualitative information about the unobservable inputs for the Company's liabilities classified as Level 3 and measured at fair value on a recurring basis at December 31, 2014 and 2013:

December 31, 2014				December 31, 2013			
Financial Instrument	Valuation Technique	Unobservable Input	Weighted Average	Financial Instrument	Valuation Technique	Unobservable Input	Weighted Average
Subordinated Debt	Discounted cash flow	Discount Rate	6.87%	Subordinated Debt	Discounted cash flow	Discount Rate	8.19%

Management believes that the credit risk adjusted spread utilized in the fair value measurement of the junior subordinated debentures carried at fair value is indicative of the nonperformance risk premium a willing market participant would require under current market conditions, that is, the inactive market. Management attributes the change in fair value of the junior subordinated debentures during the period to market changes in the nonperformance expectations and pricing of this type of debt, and not as a result of changes to our entity-specific credit risk. The narrowing of the credit risk adjusted spread above the Company's contractual spreads has primarily contributed to the negative fair value adjustments. Generally, an increase in the credit risk adjusted spread and/or a decrease in the three month LIBOR swap curve will result in positive fair value adjustments (and decrease the fair value measurement). Conversely, a decrease in the credit risk adjusted spread and/or an increase in the three month LIBOR swap curve will result in negative fair value adjustments (and increase the fair value measurement).

14. Regulatory Matters

Regulatory Agreement with the Federal Reserve Bank of San Francisco

On March 23, 2010, United Security Bancshares (the "Company") and its wholly owned subsidiary, United Security Bank (the "Bank"), entered into a formal written agreement (the “Agreement”) with the Federal Reserve Bank of San Francisco (the “Federal Reserve”) as a result of a regulatory examination that was conducted by the Federal Reserve and the California Department of Financial Institutions (the “DFI”) in June 2009. That examination found significant increases in nonperforming assets, both classified loans and OREO, during 2008 and 2009, and heightened concerns about the Bank’s use of brokered and other wholesale funding sources to fund loan growth, which created increased risk to equity capital and potential volatility in earnings.

Under the terms of the Agreement, the Company and the Bank agreed, among other things: to maintain a sound process for determining, documenting, and recording an adequate allowance for loan and lease losses; to improve the management of the Bank's liquidity position and funds management policies; to maintain sufficient capital at the Company and Bank level; and to improve the Bank's earnings and overall condition. The Company and Bank also agreed not to increase or guarantee any debt, purchase or redeem any shares of stock, declare or pay any cash dividends, or pay interest on the Company's junior subordinated debt or trust preferred securities, without prior written approval from the Federal Reserve. The Company generates no revenue of its own and, as such, relies on dividends from the Bank to pay its operating expenses and interest payments on the Company's junior subordinated debt.

Effective November 19, 2014, the Federal Reserve terminated the Agreement with the Bank and the Company and replaced it with an informal supervisory agreement that requires, among other things, obtaining written approval from the Federal Reserve prior to the payment of dividends from the Bank to the Company or the payment of dividends by the Company or interest on the Company's junior subordinated debt. The inability of the Bank to pay cash dividends to the Company may hinder the Company's ability to meet its ongoing operating obligations.

Regulatory Order from the California Department of Business Oversight

On May 20, 2010, the DFI (now known as the Department of Business Oversight (the "DBO")) issued a formal written order (the "Order") pursuant to a consent agreement with the Bank as a result of the same June 2009 joint regulatory examination. The terms of the Order were essentially similar to the Federal Reserve's Agreement, except for a few additional requirements.

On September 24, 2013, the Bank entered into an informal Memorandum of Understanding (the "MOU") with the DBO and on October 15, 2013, the Order was terminated. The Order and the MOU require the Bank to maintain a ratio of tangible shareholder's equity to total tangible assets equal to or greater than 9.0% and also requires the DBO's approval for the Bank to pay a dividend to the Company.

Accordingly, reflecting the Company's and the Bank's improved financial condition and performance, as of November 19, 2014, the Bank and the Company have been relieved of all formal regulatory agreements. Some of the governance and procedures established by the Agreement and the Order remain in place, including submission of certain plans and reports to the Federal Reserve and DBO, the Bank's obligation to maintain a 9.0% tangible shareholder's equity ratio, and the requirement to seek approvals from the Federal Reserve and the DBO for either the Bank or the Company to pay dividends and for the Company to pay interest on its outstanding junior subordinated debt. While no assurances can be given as to future regulatory approvals, over the last three quarters the DBO and the Federal Reserve have been approving the Bank's payment of dividends to the Company to cover the Company's operating expenses and its interest payments and the Company's payment of quarterly interest on the junior subordinated debt.

Capital Adequacy - The Company (on a consolidated basis) and the Bank are subject to various regulatory capital requirements adopted by the Board of Governors of the Federal Reserve System (the "Board of Governors"). Failure to meet minimum capital requirements can initiate certain mandates and possible additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the consolidated Company and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

Quantitative measures established by the capital adequacy guidelines require insured institutions to maintain a minimum leverage ratio of Tier 1 capital (the sum of common stockholders' equity, noncumulative perpetual preferred stock and minority interests in consolidated subsidiaries, minus intangible assets, identified losses and investments in certain subsidiaries, plus unrealized losses or minus unrealized gains on available for sale securities) to total assets. Institutions which have received the highest composite regulatory rating and which are not experiencing or anticipating significant growth are required to maintain a minimum leverage capital ratio of 3% of Tier 1 capital to total assets. All other institutions are required to maintain a minimum leverage capital ratio of at least 100 to 200 basis points above the 3% minimum requirement.

In addition to the general capital adequacy guidelines, pursuant to the DBO’s MOU the Bank is required to maintain a ratio of tangible shareholder’s equity to total tangible assets equal to or greater than 9.0%. For purposes of the MOU, “tangible

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shareholders' equity" is defined as shareholders' equity minus intangible assets. The Bank's ratio of tangible shareholders' equity to total tangible assets was 13.4% and 13.2% at December 31, 2014 and 2013, respectively.

The Company has adopted a capital plan that includes guidelines and trigger points to ensure sufficient capital is maintained at the Bank and the Company, and that capital ratios are maintained at a level deemed appropriate under regulatory guidelines given the level of classified assets, concentrations of credit, ALLL, current and projected growth, and projected retained earnings. The capital plan also contains contingency strategies to obtain additional capital as required to fulfill future capital requirements for both the Bank, as a separate legal entity, and the Company on a consolidated basis.

The following table shows the Company's and the Bank's regulatory capital and regulatory capital ratios at December 31, 2014 and 2013, as compared to the applicable capital adequacy guidelines:

	Actual			For Capital Adequacy Purposes			To Be Well Capitalized Under Prompt Corrective Action Provisions		
(In thousands)	Amount	Ratio		Amount	Ratio		Amount	Ratio	
As of December 31, 2014 (Company):									
Total Capital (to Risk Weighted Assets)	$91,935	17.29	%	$42,536	8.00	%	N/A	N/A	
Tier 1 Capital (to Risk Weighted Assets)	85,234	16.03	%	21,268	4.00	%	N/A	N/A	
Tier 1 Capital (to Average Assets)	85,234	12.49	%	27,295	4.00	%	N/A	N/A	
As of December 31, 2014 (Bank):									
Total Capital (to Risk Weighted Assets)	$89,889	16.91	%	$42,536	8.00	%	$53,170	10.00	%
Tier 1 Capital (to Risk Weighted Assets)	83,188	15.65	%	21,268	4.00	%	31,902	6.00	%
Tier 1 Capital (to Average Assets)	83,188	12.25	%	27,164	4.00	%	33,955	5.00	%
As of December 31, 2013 - (Company):									
Total Capital (to Risk Weighted Assets)	$77,530	15.49	%	$36,061	8.00	%	N/A	N/A	
Tier 1 Capital (to Risk Weighted Assets)	71,827	14.26	%	18,031	4.00	%	N/A	N/A	
Tier 1 Capital (to Average Assets)	71,827	10.66	%	25,672	4.00	%	N/A	N/A	
As of December 31, 2013 – (Bank):									
Total Capital (to Risk Weighted Assets)	$78,499	15.77	%	$36,061	8.00	%	$45,077	10.00	%
Tier 1 Capital (to Risk Weighted Assets)	72,796	14.54	%	18,031	4.00	%	27,046	6.00	%
Tier 1 Capital (to Average Assets)	72,796	10.95	%	25,484	4.00	%	31,855	5.00	%

The Board of Governors has also adopted a statement of policy, supplementing its leverage capital ratio requirements, which provides definitions of qualifying total capital (consisting of Tier 1 capital and Tier 2 supplementary capital, including the allowance for loan losses up to a maximum of 1.25% of risk-weighted assets) and sets forth minimum risk-based capital ratios of capital to risk-weighted assets. Insured institutions are required to maintain a ratio of qualifying total capital to risk weighted assets of 8%, at least one-half of which must be in the form of Tier 1 capital.

Under regulatory guidelines, the $15 million in Trust Preferred Securities issued by USB Capital Trust II in July of 2007 qualifies as Tier 1 capital up to 25% of Tier 1 capital. Any additional portion of Trust Preferred Securities qualifies as Tier 2 capital. As of December 31, 2014, the Company and the Bank meets all capital adequacy requirements to which they are subject.

The Federal Reserve and the Federal Deposit Insurance Corporation approved final capital rules in July 2013, that substantially amend the existing capital rules for banks. These new rules reflect, in part, certain standards initially adopted by the Basel Committee on Banking Supervision in December 2010 (which standards are commonly referred to as “Basel III”) as well as requirements contemplated by the Dodd-Frank Act.

Under the new capital rules, the Bank will be required to meet certain minimum capital requirements that differ from current capital requirements. The prompt corrective action rules are modified to include the common equity Tier 1 capital ratio and to increase the Tier 1 capital ratio requirements for the various thresholds. For example, the requirements for the Bank to be considered well-capitalized under the rules will be a 5.0% leverage ratio, a 6.5% common equity Tier 1capital ratio, an 8.0% Tier 1 capital ratio, and a 10.0% total capital ratio. To be adequately capitalized, those ratios are 4.0%, 4.5%, 6.0%, and 8.0%, respectively. The Bank is required to comply with the new capital rules on January 1, 2015, with a measurement date of March 31, 2015.

Dividends – Cash dividends, if any, paid to shareholders are paid by the Company, subject to restrictions set forth in the California Corporations Code and the terms of the Federal Reserve informal supervisory agreement. All dividends paid by the Company during 2014 and 2013 were in the form of stock dividends rather than cash dividends.

The primary source of funds with which cash dividends are paid to shareholders comes from cash dividends received by the Company from the Bank. The Bank's ability to pay dividends is subject to the restrictions set forth in the California Financial Code and the informal agreements the Bank has entered into with the Federal Reserve and the DBO. Under the Financial Code, the Bank may not pay cash dividends in an amount which exceeds the lesser of the retained earnings of the Bank or the Bank's net income for the last three fiscal years (less the amount of distributions to shareholders during that period of time). If the above test is not met, cash dividends may only be paid with the prior approval of the DBO, in an amount not exceeding the greater of: (i) the Bank's retained earnings; (ii) its net income for the last fiscal year; or (iii) its net income for the current fiscal year. During the year ended December 31, 2014, the Bank's cash dividends of $1,519,000 paid to the Company were approved by the Federal Reserve and the DBO and funded the Company's operating costs and payments of interest on its junior subordinated debentures.

Cash Restrictions - The Bank is required to maintain average reserve balances with the Federal Reserve. In prior years, the Bank implemented a deposit reclassification program, which allows the Bank to reclassify a portion of its transaction accounts to non-transaction accounts for reserve purposes. The deposit reclassification program was provided by a third-party vendor, and has been approved by the Federal Reserve Bank.

15. Supplemental Cash Flow Disclosures

	Year Ended December 31,	
(In thousands)	2014	2013
Cash paid (received) during the period for:		
Interest	$2,462	$1,356
Income Taxes	—	(3,679)
Noncash investing activities:		
Loans transferred to foreclosed property	1,308	437
Financed OREO	—	2,328

16. Common Stock Dividend

The Company declared one-percent (1)% common stock dividends during each of the four quarters ended December 31, 2014, September 30, 2014, June 30, 2014, and March 31, 2014. All 1% stock dividends were considered "small stock dividends" resulting in a transfer between retained earnings and common stock an amount equal to the number of shares issued in the stock dividend multiplied by the stock's closing price at the date of declaration. Other than for earnings-per-share calculations, shares issued for the stock dividend have been treated prospectively for financial reporting purposes. For purposes of earnings per share calculations, the Company's weighted average shares outstanding and potentially dilutive shares used in the computation of earnings per share have been restated after giving retroactive effect to a 1% stock dividend to shareholders for all periods presented.

The Company declared one-percent (1)% common stock dividends during each of the four quarters ended December 31, 2013, September 30, 2013, June 30, 2012, and March 31, 2013. All 1% stock dividends were considered "small stock dividends" resulting in a transfer between retained earnings and common stock an amount equal to the number of shares issued in the stock dividend multiplied by the stock's closing price at the date of declaration. Other than for earnings-per-share calculations, shares issued for the stock dividend have been treated prospectively for financial reporting purposes. For purposes of earnings per share calculations, the Company's weighted average shares outstanding and potentially dilutive shares used in the computation of earnings per share have been restated after giving retroactive effect to a 1% stock dividend to shareholders for all periods presented.

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17. Net Income Per Share

The following table provides a reconciliation of the numerator and the denominator of the basic EPS computation with the numerator and the denominator of the diluted EPS computation. (Weighted average shares have been adjusted to give retroactive recognition for the 1% stock dividend for each of the quarters since the third quarter ended September 30, 2008):

	Year Ended December 31,	
(In thousands, except earnings per share data)	2014	2013
Net income available to common shareholders	$6,216	$7,269
Weighted average shares outstanding	15,410,733	15,398,911
Add: dilutive effect of stock options	4,931	605
Weighted average shares outstanding adjusted for potential dilution	15,415,664	15,399,516
Basic earnings per share	$0.40	$0.49
Diluted earnings per share	$0.40	$0.49
Anti-dilutive shares excluded from earnings per share calculation	138,000	195,000

18. Common Stock Repurchase Plan

On May 16, 2007, the Company's Board of Directors approved a plan to repurchase, as conditions warrant, up to 781,384 shares of the Company's common stock on the open market or in privately negotiated transactions. The repurchase plan represents approximately 5.00% of the Company's currently outstanding common stock. The duration of the program is open-ended and the timing of purchases will depend on market conditions. As of December 31, 2014, there were 676,503 shares available for repurchase.

As a condition of the MOU entered into with the Federal Reserve Bank of San Francisco (FRB) on November 19, 2014, and the MOU entered into with the California Department of Business Oversight (DBO) on September 24, 2013, the Company may not repurchase any of its common stock without prior approval of the FRB and the DBO. The Company did not repurchase any common shares during the years ended December 31, 2014 and 2013.

19. Goodwill and Intangible Assets

At December 31, 2014, the Company had $4,488,000 of goodwill and no core deposit intangibles. The following table summarizes the carrying value of those assets at December 31, 2014 and 2013.

(In thousands)	December 31, 2014	December 31, 2013
Goodwill	$4,488	$4,488
Core deposit intangible assets	—	62
Total goodwill and intangible assets	$4,488	$4,550

Core deposit intangibles and other identified intangible assets are amortized over their useful lives, while goodwill is not amortized. The Company conducts periodic impairment analysis on goodwill and intangible assets and goodwill at least annually or more often as conditions require. The following table summarizes the amortization expense and impairment losses recorded on the Company's intangible assets and goodwill for the years ended December 31, 2014 and 2013.

(In thousands)	December 31, 2014	December 31, 2013
Amortization expense - core deposit intangibles	$62	$187
Amortization expense - other intangibles	—	—
Total amortization expense	$62	$187
Impairment losses - core deposit intangibles	$—	$—
Impairment losses - goodwill	—	—

Total impairment losses	$—	$—

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Goodwill: The largest component of goodwill is related to the Legacy merger (Campbell reporting unit) completed during February 2007 and totaled approximately $2.9 million at December 31, 2014. The Company completed a "Step 0" analysis for the Campbell reporting unit as of March 31, 2014, and a "Step 1" at March 31, 2013, with no goodwill impairment.

The first step in impairment testing is to identify potential impairment, which involves determining and comparing the fair value of the operating unit with its carrying value. If the fair value of the reporting unit exceeds its carrying value, goodwill is not impaired. If the carrying value exceeds fair value, there is an indication of possible impairment and the second step is performed to determine the amount of the impairment, if any. The fair value determined in the step one testing is determined based on a discounted cash flow methodology using estimated market discount rates and projections of future cash flows for the Campbell reporting unit. In addition to projected cash flows, the Company also utilizes other market metrics including industry multiples of earnings and price-to-book ratios to estimate what a market participant would pay for the operating unit in the current business environment. Determining the fair value involves a significant amount of judgment, including estimates of changes in revenue growth, changes is discount rates, competitive forces within the industry, and other specific industry and market valuation conditions. If at the conclusion of the step 1 analysis, the Company concludes that the potential for goodwill impairment exists, step-two testing will be required to determine goodwill impairment and the amount of goodwill that might be impaired, if any. The second step in impairment analysis compares the fair value of the Campbell reporting unit to the aggregate fair values of its individual assets, liabilities and identified intangibles. Based on the results of the first step of the impairment analysis at December 31, 2014, the Company concluded that that the fair value of the reporting unit exceeds it carrying value; therefore, goodwill was not impaired.

Core Deposit Intangibles: The core deposit intangible asset, which totaled $3.0 million at the time of merger, is being amortized over an estimated life of approximately seven years. The Company recognized no amortization expense related to the Legacy operating unit during the year ended December 31, 2014. At December 31, 2014, there was no remaining carrying value of the core deposit intangible related to the Legacy Bank merger. At December 31, 2014 and 2013, there was $0 and $62,000, respectively, in remaining carrying value of core deposit intangible related to the Taft branch acquisitions completed in April, 2004.

20. Parent Company Only Financial Statements

The following are the condensed financial statements of United Security Bancshares and should be read in conjunction with the consolidated financial statements:

United Security Bancshares – (parent only)
Balance Sheets - December 31, 2014 and 2013

(In thousands)	2014	2013
Assets		
Cash and equivalents	$224	$66
Investment in bank subsidiary	93,170	87,775
Other assets	1,975	2,298
Total assets	95,369	90,139
Liabilities & Shareholders' Equity		
Liabilities:		
Junior subordinated debt securities (at fair value)	10,114	11,125
Deferred taxes	2,429	2,471
Total liabilities	12,543	13,596
Shareholders' Equity:		

Common stock, no par value 20,000,000 shares authorized, 15,425,086 and 14,799,888 issued and outstanding, in 2014 and 2013	49,271	45,778
Retained earnings	33,730	30,884
Accumulated other comprehensive (loss) income	(175)	(119)
Total shareholders' equity	82,826	76,543
Total liabilities and shareholders' equity	$95,369	$90,139

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United Security Bancshares – (parent only) Income Statements	Year ended December 31,	
(In thousands)	2014	2013
Income		
Loss on fair value option of financial assets	$(102)	$(776)
Dividends from subsidiary	1,519	—
Total (loss) income	1,417	(776)
Expense		
Interest expense	241	281
Other expense	101	159
Total expense	342	440
(Loss) Income before taxes and equity in undistributed income of subsidiary	1,075	(1,216)
Income tax benefit	(182)	(500)
Undistributed income of subsidiary	4,959	7,985
Net Income	$6,216	$7,269

United Security Bancshares – (parent only) Statement of Cash Flows	Year ended December 31,	
(In thousands)	2014	2013
Cash Flows From Operating Activities		
Net income	$6,216	$7,269
Adjustments to reconcile net income to cash provided by operating activities:		
Equity in undistributed income of subsidiary	(4,959)	(7,985)
Provision for deferred income taxes	(42)	1,232
Loss on fair value option of financial liability	102	776
Increase in income tax receivable	(140)	(1,732)
Net change in other assets/liabilities	(1,114)	198
Net cash provided by (used in) operating activities	63	(242)
Cash Flows From Financing Activities		
Proceeds from exercise of stock options	95	12
Net cash provided by financing activities	95	12
Net increase (decrease) in cash and cash equivalents	158	(230)
Cash and cash equivalents at beginning of year	66	296
Cash and cash equivalents at end of year	$224	$66
Supplemental cash flow disclosures		
Non-cash financing activities:		
Dividends declared not paid	$—	$—

21. Subsequent Events

Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued. Recognized subsequent events are events or transactions that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. Nonrecognized subsequent events are events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date. Management has reviewed events occurring through the date the financial statements were issued and no subsequent events occurred requiring accrual or disclosure.

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Item 9 - Changes in and Disagreements with Accountants on Accounting and Financial Disclosure
None.

Item 9A. Controls and Procedures

CONCLUSION REGARDING THE EFFECTIVENESS OF DISCLOSURE CONTROLS AND PROCEDURES

As of the end of the period covered by this report, the Company carried out an evaluation, under the supervision and with the participation of the Company’s management, including the Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the design and operation of the Company’s disclosure controls and procedures, as defined in the Securities and Exchange Act Rule 13(a)-15(e). Based on that evaluation and the remediation of the material weaknesses in the Company’s internal control over financial reporting above under the caption “Management’s Report on Internal Control Over Financial Reporting” in Item 8 of this report ,” the Chief Executive Officer and Chief Financial Officer have concluded that the Company’s disclosure controls and procedures were effective at December 31, 2014 to ensure that information required to be disclosed in its reports that the Company files or submits to the Securities and Exchange Commission under the Exchange Act is recorded, processed, summarized and reported on a timely basis. The Company’s Chief Executive Officer and Chief Financial Officer have certified that, based on their knowledge, the Company’s Consolidated Financial Statements included in this report fairly present in all material respects the Company’s financial condition, results of operations and cash flows for the periods presented in this report.

Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, the Company has included a report of management’s assessment of the design and operating effectiveness of its internal controls as part of this report.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

There have not been any changes in the Company's internal control over financial reporting that occurred during the year ended December 31, 2014, that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

The Company does not expect that its disclosure controls and procedures and internal control over financial reporting will prevent all error and fraud. A control procedure, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control procedure are met. Because of the inherent limitations in all control procedures, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns in controls or procedures can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any control procedure is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control procedure, misstatements due to error or fraud may occur and not be detected.

Item 9B. Other Information

None

PART III

Item 10 – Directors, Executive Officers, and Corporate Governance

Pursuant to Instruction G, the information required by this item is hereby incorporated herein by reference from the captions entitled "Election of Directors and Executive Officers" and “Corporate Governance Principles and Board Matters” set forth in the Company's definitive Proxy Statement for its 2015 Annual Meeting of Shareholders ("Proxy Statement").

Item 11 - Executive Compensation

Pursuant to Instruction G, the information required by this item is hereby incorporated herein by reference from the captions entitled "Executive Compensation" and “Director Compensation” set forth in the Company's definitive Proxy Statement for its 2015 Annual Meeting of Shareholders ("Proxy Statement").

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Item 12 - Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Pursuant to Instruction G, the information required by this item is hereby incorporated herein by reference from the caption entitled "Shareholdings of Certain Beneficial Owners and Management" set forth in the Company's definitive Proxy Statement for its 2015 Annual Meeting of Shareholders ("Proxy Statement").

Item 13 - Certain Relationships and Related Transactions, and Director Independence

Pursuant to Instruction G, the information required by this item is hereby incorporated herein by reference from the captions entitled "Certain Transactions" and “Corporate Governance Principles” set forth in the Company's definitive Proxy Statement for its 2015 Annual Meeting of Shareholders ("Proxy Statement").

Item 14 - Principal Accounting Fees and Services

Pursuant to Instruction G, the information required by this item is hereby incorporated herein by reference from the caption entitled "Independent Accountant Fees and Services" set forth in the Company's definitive Proxy Statement for its 2015 Annual Meeting of Shareholders ("Proxy Statement").

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PART IV

Item 15 – Exhibits and Financial Statement Schedules

(a)(1) Financial Statements

The Consolidated Financial Statements and related documents set forth in “Item 8. Financial Statements and Supplementary Data” of this report are filed as part of this report.

(a)(2) Financial Statement Schedules

All financial statement schedules are omitted because they are not applicable or not required or because the information is included in the financial statements or notes thereto or is not material.

(a)(3) Exhibits

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3.1	Articles of Incorporation of Registrant (1)
3.2	Bylaws of Registrant (1)
4.1	Specimen common stock certificate of United Security Bancshares (1)
10.1	Amended and Restated Executive Salary Continuation Agreement for Dennis Woods (4)
10.2	Amended and Restated Employment Agreement for Dennis R. Woods (4)
10.3	Amended and Restated Executive Salary Continuation Agreement for Kenneth Donahue (4)
10.4	Amended and Restated Change in Control Agreement for Kenneth Donahue (4)
10.5	Amended and Restated Executive Salary Continuation Agreement for David Eytcheson (4)
10.6	Amended and Restated Change in Control Agreement for David Eytcheson (4)
10.7	Amended and Restated Executive Salary Continuation Agreement for Rhodlee Braa (4)
10.8	Amended and Restated Change in Control Agreement for Rhodlee Braa (4)
10.9	Amended and Restated Executive Salary Continuation Agreement for William F. Scarborough (4)
10.10	Amended and Restated Change in Control Agreement for William F. Scarborough (4)
10.11	USB 2005 Stock Option Plan. Filed as Exhibit B to the Company's 2005 Schedule 14A Definitive Proxy filed April 18, 2005 and incorporated herein by reference.
10.12	Stock Option Agreement for William F. Scarborough dated August 1, 2005 (2)
10.13	Stock Option Agreement for Dennis R. Woods dated February 6, 2006 (3)
10.14	Written Agreement between United Security Bancshares, United Security Bank, and the Federal Reserve Bank of San Francisco dated March 23, 2010 (5)
10.15	Stock Option Agreement for Richard B. Shupe dated February 7, 2010 (6)
11.1	Computation of earnings per share.

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	See Note 19 to Consolidated Financial Statements and related documents set forth in “Item 8. Financial Statements and Supplementary Data” of this report are filed as part of this report.
21	Subsidiaries of the Company
23.1	Consent of Moss Adams LLP, Independent Registered Public Accounting Firm
31.1	Certification of the Chief Executive Officer of United Security Bancshares pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Chief Financial Officer of United Security Bancshares pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of the Chief Executive Officer of United Security Bancshares pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of the Chief Financial Officer of United Security Bancshares pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(1) Previously filed on April 4, 2001 as an exhibit to the Company’s filing on Form S-4 (file number 333-58256).
(2) Previously filed on March 15, 2006 as an exhibit to the Company’s filing on Form 10-K for the year ended December 31, 2006 (file number 000-32897).
(3) Previously filed on November 7, 2006 as an exhibit to the Company’s filing on Form 10-Q/A for the period ended March 31, 2006 (file number 000-32897).
(4) Previously filed on March 17, 2007 as an exhibit to the Company’s filing on Form 10-K for the year ended December 31, 2007 (file number 000-32897).
(5) Previously filed on March 25, 2010 as an exhibit to the Company’s filing on Form 8-K (file number 000-32897).
(6) Previously filed on April 4, 2011 as an exhibit to the Company’s filing on Form 10-K for the year ended December 31, 2010 (file number 000-32897)..

(b) Exhibits filed:

See Exhibit Index under Item 15(a)(3) above for the list of exhibits required to be filed by Item 601 of regulation S-K with this report.

(c) Financial statement schedules filed:

See Item 15(a)(2) above.

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Signatures

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report on Form 10-K for the year ended December 31, 2014 to be signed on its behalf by the undersigned thereunto duly authorized, in Fresno, California, on the 17th day of March 2015.

United Security Bancshares

March 17, 2015	/S/ Dennis R. Woods Dennis R. Woods President and Chief Executive Officer
March 17, 2015	/S/ Kenneth L. Donahue Kenneth L. Donahue Executive Vice President and Acting Chief Financial Officer

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Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities on the date indicated:

Date:	March 17, 2015	/s/ Robert G. Bitter Director
Date:	March 17, 2015	/s/ Stanley J. Cavalla Director
Date:	March 17, 2015	/s/ Tom Ellithorpe Director
Date:	March 17, 2015	/s/ Kenneth D. Newby Director
Date:	March 17, 2015	/s/ Ronnie D. Miller Director
Date:	March 17, 2015	/s/ Robert M. Mochizuki Director
Date:	March 17, 2015	/s/ Walter Reinhard Director
Date:	March 17, 2015	/s/ John Terzian Director
Date:	March 17, 2015	/s/ Mike Woolf Director