

UNITED SECURITY BANCSHARES

Form 10-Q

May 05, 2016

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SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2016

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: 000-32897

UNITED SECURITY BANCSHARES

(Exact name of registrant as specified in its charter)

CALIFORNIA

(State or other jurisdiction of incorporation or organization)

91-2112732

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

2126 Inyo Street, Fresno, California

(Address of principal executive offices)

93721

(Zip Code)

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

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

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 No

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act).

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

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

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

Common Stock, no par value

(Title of Class)

Shares outstanding as of April 30, 2016: 16,051,406

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PART I. Financial Information

United Security Bancshares and Subsidiaries

Consolidated Balance Sheets – (unaudited)

March 31, 2016 and December 31, 2015

(in thousands except shares)	March 31, 2016	December 31, 2015
Assets		
Cash and non-interest bearing deposits in other banks	\$24,020	\$ 29,733
Cash and due from Federal Reserve Bank	101,469	96,018
Cash and cash equivalents	125,489	125,751
Interest-bearing deposits in other banks	1,530	1,528
Investment securities available for sale (at fair value)	44,394	30,893
Loans	517,678	515,318
Unearned fees and unamortized loan origination costs, net	611	58
Allowance for credit losses	(9,718	) (9,713
Net loans	508,571	505,663
Accrued interest receivable	2,741	2,220
Premises and equipment – net	10,666	10,800
Other real estate owned	12,207	12,873
Goodwill	4,488	4,488
Cash surrender value of life insurance	18,468	18,337
Investment in limited partnerships	1,012	917
Deferred tax assets - net	5,052	5,228
Other assets	7,173	6,946
Total assets	\$741,791	\$ 725,644
Liabilities & Shareholders' Equity		
Liabilities		
Deposits		
Noninterest bearing	\$261,827	\$ 262,168
Interest bearing	375,500	359,637
Total deposits	637,327	621,805
Accrued interest payable	33	29
Accounts payable and other liabilities	5,029	5,875
Junior subordinated debentures (at fair value)	7,948	8,300
Total liabilities	650,337	636,009
Shareholders' Equity		
Common stock, no par value 20,000,000 shares authorized, 16,211,898 issued and outstanding at March 31, 2016, and 16,051,406 at December 31, 2015	53,366	52,572
Retained earnings	38,248	37,265
Accumulated other comprehensive loss	(160	) (202
Total shareholders' equity	91,454	89,635
Total liabilities and shareholders' equity	\$741,791	\$ 725,644

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

(In thousands except shares and EPS)	Three Months Ended March 31,	
	2016	2015
Interest Income:		
Loans, including fees	\$6,631	\$ 6,279
Investment securities – AFS – taxable	189	214
Interest on deposits in FRB	124	46
Interest on deposits in other banks	2	2
Total interest income	6,946	6,541
Interest Expense:		
Interest on deposits	277	259
Interest on other borrowings	58	58
Total interest expense	335	317
Net Interest Income	6,611	6,224
(Recovery of Provision) Provision for Credit Losses	(22	) 459
Net Interest Income after (Recovery of Provision) Provision for Credit Losses	6,633	5,765
Noninterest Income:		
Customer service fees	926	833
Increase in cash surrender value of bank-owned life insurance	131	128
Gain (loss) on fair value of financial liability	358	(125
Other	146	85
Total noninterest income	1,561	921
Noninterest Expense:		
Salaries and employee benefits	2,590	2,431
Occupancy expense	1,097	940
Data processing	59	31
Professional fees	489	348
Regulatory assessments	256	246
Director fees	70	56
Correspondent bank service charges	20	19
Loss on California tax credit partnership	37	30
Net cost on operation of OREO	116	68
Other	566	539
Total noninterest expense	5,300	4,708
Income Before Provision for Taxes	2,894	1,978
Provision for Taxes on Income	1,125	750
Net Income	\$1,769	\$ 1,228
Net Income per common share		
Basic	\$0.11	\$ 0.08
Diluted	\$0.11	\$ 0.08
Shares on which net income per common shares were based		
Basic	16,211,898	16,211,898
Diluted	16,215,056	16,213,839

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

(In thousands)	Three Months Ended March 31, 2016	Three Months Ended March 31, 2015
Net Income	\$1,769	\$1,228
Unrealized holdings gains on securities	59	120
Unrealized gains on unrecognized post-retirement costs	12	19
Other comprehensive income, before tax	71	139
Tax expense related to securities	(24)	(48)
Tax expense related to unrecognized post-retirement costs	(5)	(8)
Total other comprehensive income	42	83
Comprehensive income	\$1,811	\$1,311

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

(In thousands except shares)	Common stock		Retained Earnings	Accumulated	Total
	Number of Shares	Amount		Other Comprehensive Loss	
Balance December 31, 2014	15,425,086	\$49,271	\$33,730	\$ (175)	\$82,826
Other comprehensive income				83	83
Common stock dividends	154,249	828	(828)		—
Stock-based compensation expense		7			7
Net income			1,228		1,228
Balance March 31, 2015	15,579,335	\$50,106	\$34,130	\$ (92)	\$84,144
Other comprehensive loss				(110)	(110)
Common stock dividends	472,071	2,447	(2,447)		—
Stock-based compensation expense		19			19
Net income			5,582		5,582
Balance December 31, 2015	16,051,406	\$52,572	\$37,265	\$ (202)	\$89,635
Other comprehensive income				42	42
Common stock dividends	160,492	786	(786)		—
Stock-based compensation expense		8			8
Net income			1,769		1,769
Balance March 31, 2016	16,211,898	\$53,366	\$38,248	\$ (160)	\$91,454

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United Security Bancshares and Subsidiaries

Consolidated Statements of Cash Flows (unaudited)

(In thousands)	Three months ended	
	March 31, 2016	2015
Cash Flows From Operating Activities:		
Net Income	\$1,769	\$1,228
Adjustments to reconcile net income:to cash provided by operating activities:		
(Recovery of provision) provision for credit losses	(22	) 459
Depreciation and amortization	363	355
Amortization of investment securities	82	65
Accretion of investment securities	(10	) (6)
Increase in accrued interest receivable	(521	) (57)
Increase in accrued interest payable	4	2
Decrease in accounts payable and accrued liabilities	(843	) (1)
Increase in unearned fees	(553	) (639)
Decrease in income taxes receivable	768	801
Stock-based compensation expense	8	7
Benefit (provision) for deferred income taxes	147	(51)
Increase in cash surrender value of bank-owned life insurance	(131	) (128)
(Gain) loss on fair value option of financial liabilities	(358	) 125
Loss on tax credit limited partnership interest	37	30
Net increase in other assets	(979	) (126)
Net cash (used in) provided by operating activities	(239	) 2,064
Cash Flows From Investing Activities:		
Net increase in interest-bearing deposits with banks	(2	) (1)
Purchase of correspondent bank stock	(1) —
Purchases of available-for-sale securities	(14,940) —
Principal payments of available-for-sale securities	1,426	1,464
Net increase in loans	(2,491	) (34,266)
Cash proceeds from sales of other real estate owned	824	—
Investment in limited partnership	(132	) (119)
Capital expenditures of premises and equipment	(229	) (136)
Net cash used in investing activities	(15,545	) (33,058)
Cash Flows From Financing Activities:		
Net increase in demand deposits and savings accounts	11,561	13,414
Net increase (decrease) in time deposits	3,961	(519)
Net cash provided by financing activities	15,522	12,895
Net decrease in cash and cash equivalents	(262	) (18,099)
Cash and cash equivalents at beginning of period	125,751	103,577
Cash and cash equivalents at end of period	\$125,489	\$85,478

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

1. Organization and Summary of Significant Accounting and Reporting Policies

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

These unaudited financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information on a basis consistent with the accounting policies reflected in the audited financial statements of the Company included in its 2015 Annual Report on Form 10-K. These interim financial statements do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of a normal, recurring nature) considered necessary for a fair presentation have been included. Operating results for the interim periods presented are not necessarily indicative of the results that may be expected for any other interim period or for the year as a whole.

Recently Issued Accounting Standards:

In March 30, 2016 FASB issued ASU 2016-09, Compensation-Stock Compensation (Topic 718). The Board is issuing this Update as part of its Simplification Initiative. The objective of the Simplification Initiative is to identify, evaluate, and improve areas of generally accepted accounting principles (GAAP) for which cost and complexity can be reduced while maintaining or improving the usefulness of the information provided to users of financial statements. The areas for simplification in this Update were identified through outreach for the Simplification Initiative, pre-agenda research for the Private Company Council, and the August 2014 Post-Implementation Review Report on FASB No. 123(R), Share-Based Payment. We are currently evaluating the impacts of this ASU on the consolidated financial statements.

In February 2016 FASB issued ASU 2016-02, Leases (Topic 842). The FASB is issuing this Update to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. To meet that objective, the FASB is amending the FASB Accounting Standards Codification® and creating Topic 842, Leases. This Update, along with IFRS 16, Leases, are the results of the FASB’s and the International Accounting Standards Board’s (IASB’s) efforts to meet that objective and improve financial reporting. We are currently evaluating the impacts of this ASU on the consolidated financial statements.

In January 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2016-01 Financial Instruments-Overall: Recognition and Measurements of Financial Assets and Financial Liabilities. This ASU requires equity investments to be measured at fair value, with changes in fair value recognized in net income. The amendment also simplifies the impairment assessment of equity investments for which fair value is not readily determinable by requiring an entity to perform a qualitative assessment to identify impairment. The ASU is effective for fiscal years beginning after December 15, 2017, and interim periods therein. We are currently evaluating the impacts of this ASU on the consolidated financial statements.

In September 2015, FASB issued ASU 2015-16, Business Combinations (Topic 805) -Simplifying the Accounting for Measurement-Period Adjustments. GAAP requires that during the amendment period, the acquirer retrospectively adjust the provisional amounts recognized at the acquisition date with a corresponding adjustment to goodwill. Those adjustments are required when new information is obtained about facts and circumstances that existed as of the acquisition date that, if known, would have affected the measurement of the amounts initially recognized or would have resulted in the recognition of additional assets or liabilities. To simplify the accounting for adjustments made to

provisional amounts recognized in a business combination, the amendments in this Update eliminate the requirement to retrospectively account for those adjustments. These amendments in this Update are effective for fiscal years beginning after December 15, 2015. The Company does not expect any impact on the Company's consolidated financial statements resulting from the adoption of the update.

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2. Investment Securities

Following is a comparison of the amortized cost and fair value of securities available-for-sale, as of March 31, 2016 and December 31, 2015:

(in 000's)

March 31, 2016

Securities available for sale:

U.S. Government agencies

U.S. Government sponsored entities & agencies collateralized by mortgage obligations

Mutual Funds

Total securities available for sale

(in 000's)

December 31, 2015

Securities available for sale:

U.S. Government agencies

U.S. Government sponsored entities & agencies collateralized by mortgage obligations

Mutual Funds

Total securities available for sale

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value (Carrying Amount)
U.S. Government agencies	\$ 14,003	\$ 476	\$ (109)	\$ 14,370
U.S. Government sponsored entities & agencies collateralized by mortgage obligations	26,052	214	(96)	26,170
Mutual Funds	4,000	—	(146)	3,854
Total securities available for sale	\$ 44,055	\$ 690	\$ (351)	\$ 44,394

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value (Carrying Amount)
U.S. Government agencies	\$ 9,778	\$ 453	\$ (108)	\$ 10,123
U.S. Government sponsored entities & agencies collateralized by mortgage obligations	16,835	175	(52)	16,958
Mutual Funds	4,000	—	(188)	3,812
Total securities available for sale	\$ 30,613	\$ 628	\$ (348)	\$ 30,893

The amortized cost and fair value of securities available for sale at March 31, 2016, 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. Mutual funds are included in the "due in one year or less" category below.

(in 000's)	March 31, 2016	
	Amortized Cost	Fair Value (Carrying Amount)
Due in one year or less	\$4,009	\$ 3,863
Due after one year through five years	—	—
Due after five years through ten years	963	980
Due after ten years	13,031	13,381
Collateralized mortgage obligations	26,052	26,170
	\$44,055	\$ 44,394

There were no realized gains or losses on sales of available-for-sale securities for the three month periods ended March 31, 2016 and March 31, 2015. There were no other-than-temporary impairment losses for the three month periods ended March 31, 2016 and March 31, 2015.

At March 31, 2016, available-for-sale securities with an amortized cost of approximately \$15,281,300 (fair value of \$15,770,640) were pledged as collateral for FHLB borrowings and public funds balances.

The Company had no held-to-maturity or trading securities at March 31, 2016 or December 31, 2015.

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:

(in 000's)	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
March 31, 2016						
Securities available for sale:	(Carrying Amount)	(Carrying Amount)	(Carrying Amount)	(Carrying Amount)	(Carrying Amount)	(Carrying Amount)
U.S. Government agencies	\$1,980	\$ (8)	\$76	\$ (101)	\$2,056	\$ (109)
U.S. Government sponsored entities & agencies collateralized by mortgage obligations	11,655	(96)	—	—	11,655	(96)
Mutual Funds	—	—	3,854	(146)	3,854	(146)
Total impaired securities	\$13,635	\$ (104)	\$3,930	\$ (247)	\$17,565	\$ (351)
December 31, 2015						
Securities available for sale:						
U.S. Government agencies	\$79	\$ (108)	\$—	\$ —	\$79	\$ (108)
U.S. Government sponsored entities & agencies collateralized by mortgage obligations	9,913	(52)	—	—	9,913	(52)
Mutual Funds	—	—	3,812	(188)	3,812	(188)
Total impaired securities	\$9,992	\$ (160)	\$3,812	\$ (188)	\$13,804	\$ (348)

Temporarily impaired securities at March 31, 2016, were comprised of one mutual fund, and two U.S. government agency securities, and four U.S. government sponsored entities and agencies collateralized by mortgage obligations.

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

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

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

Additionally, other-than-temporary-impairment occurs when the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss. If the Company intends to sell or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the other-than-temporary-impairment shall be recognized in earnings equal to the entire

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

At March 31, 2016, the decline in market value of the impaired mutual fund, the two U.S. government agency securities, and the two U.S. government sponsored entities and agencies collateralized by mortgage obligations is attributable to changes in interest rates, and not credit quality. Because the Company does not have the intent to sell these impaired securities, and it is not more likely than not that it will be required to sell these securities before its anticipated recovery, the Company does not consider these securities to be other-than-temporarily impaired at March 31, 2016.

3. Loans

Loans are comprised of the following:

(in 000's)	March 31, December 31,	
	2016	2015
Commercial and Business Loans	\$57,012	\$ 54,503
Government Program Loans	2,047	1,323
Total Commercial and Industrial	59,059	55,826
Real Estate – Mortgage:		
Commercial Real Estate	178,322	182,554
Residential Mortgages	78,888	68,811
Home Improvement and Home Equity loans	778	867
Total Real Estate Mortgage	257,988	252,232
Real Estate Construction and Development	129,282	130,596
Agricultural	44,767	52,137
Installment	26,582	24,527
Total Loans	\$517,678	\$ 515,318

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

Commercial and industrial loans represent 11.4% of total loans at March 31, 2016 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 49.8% of total loans at March 31, 2016, are secured by trust deeds on primarily commercial property, but are also secured by trust deeds on single family residences. Repayment of real

estate mortgage loans generally comes from the cash flow of the borrower.

Commercial real estate mortgage loans comprise the largest segment of this loan category and are available on all types of income producing and commercial properties, including: office buildings, 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.

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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 a majority are conventional mortgages that were purchased as a pool. Most residential mortgages originated by the Company are of a shorter term than conventional mortgages, with maturities ranging from 3 to 15 years on average.

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

Real estate construction and development loans, representing 25.0% of total loans at March 31, 2016, consist of loans for residential and commercial construction projects, as well as land acquisition and development, or land held for future development. Loans in this category are secured by real estate including improved and unimproved land, as well as single-family residential, multi-family residential, and commercial properties in various stages of completion. All real estate loans have established equity requirements. Repayment on construction loans generally comes from long-term mortgages with other lending institutions obtained at completion of the project.

Agricultural loans represent 8.6% of total loans at March 31, 2016 and are generally secured by land, equipment, inventory and receivables. Repayment is from the cash flow of the borrower.

Installment loans represent 5.1% of total loans at March 31, 2016 and generally consist of loans to individuals for household, family and other personal expenditures such as credit cards, automobiles or other consumer items.

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 March 31, 2016 and December 31, 2015, these financial instruments include commitments to extend credit of \$115,270,000 and \$107,084,000, respectively, and standby letters of credit of \$3,553,000 and \$3,295,000, respectively. These instruments involve elements of credit risk in excess of the amount recognized on the consolidated 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. A majority 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.

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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 March 31, 2016 (in 000's):

March 31, 2016	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	\$ —	\$ —	\$ —	\$ —	\$57,012	\$57,012	\$ —
Government Program Loans	—	—	—	—	2,047	2,047	—
Total Commercial and Industrial	—	—	—	—	59,059	59,059	—
Commercial Real Estate Loans	—	708	—	708	177,614	178,322	—
Residential Mortgages	62	—	389	451	78,437	78,888	—
Home Improvement and Home Equity Loans	—	—	—	—	778	778	—
Total Real Estate Mortgage	62	708	389	1,159	256,829	257,988	—
Real Estate Construction and Development Loans	—	—	—	—	129,282	129,282	—
Agricultural Loans	—	—	—	—	44,767	44,767	—
Consumer Loans	—	—	—	—	26,332	26,332	—
Overdraft Protection Lines	—	—	—	—	55	55	—
Overdrafts	—	—	—	—	195	195	—
Total Installment	—	—	—	—	26,582	26,582	—
Total Loans	\$ 62	\$ 708	\$ 389	\$ 1,159	\$516,519	\$517,678	\$ —

The following is a summary of delinquent loans at December 31, 2015 (in 000's):

December 31, 2015	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	\$ —	\$ —	\$ —	\$ —	\$54,503	\$54,503	\$ —
Government Program Loans	13	—	—	13	1,310	1,323	—
Total Commercial and Industrial	13	—	—	13	55,813	55,826	—
Commercial Real Estate Loans	721	—	—	721	181,833	182,554	—
Residential Mortgages	62	392	—	454	68,357	68,811	—
Home Improvement and Home Equity Loans	—	39	—	39	828	867	—
Total Real Estate Mortgage	783	431	—	1,214	251,018	252,232	—
Real Estate Construction and Development Loans	—	706	—	706	129,890	130,596	—
Agricultural Loans	—	—	—	—	52,137	52,137	—
Consumer Loans	—	650	—	650	23,657	24,307	—
Overdraft Protection Lines	—	—	—	—	61	61	—
Overdrafts	—	—	—	—	159	159	—
Total Installment	—	650	—	650	23,877	24,527	—
Total Loans	\$ 796	\$ 1,787	\$ —	\$ 2,583	\$512,735	\$515,318	\$ —

Nonaccrual Loans

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

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- 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 nonaccrual 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 nonaccrual 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 nonaccrual 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 are credited to interest income as received.

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

Nonaccrual loans totaled \$8,353,000 and \$8,193,000 at March 31, 2016 and December 31, 2015, respectively. There were no remaining undisbursed commitments to extend credit on nonaccrual loans at March 31, 2016 or December 31, 2015.

The following is a summary of nonaccrual loan balances at March 31, 2016 and December 31, 2015 (in 000's).

	March 31, 2016	December 31, 2015
Commercial and Business Loans	\$648	\$ —
Government Program Loans	307	328
Total Commercial and Industrial	955	328
Commercial Real Estate Loans	1,224	1,243
Residential Mortgages	389	392
Home Improvement and Home Equity Loans	—	—

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Total Real Estate Mortgage	1,613	1,635
Real Estate Construction and Development Loans	4,808	5,580
Agricultural Loans	—	—
Consumer Loans	977	650
Overdraft Protection Lines	—	—
Overdrafts	—	—
Total Installment	977	650
Total Loans	\$8,353	\$ 8,193

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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 nonaccrual 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. For loans that are not considered collateral dependent, a discounted cash flow methodology is used.

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

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

The method for recognizing interest income on impaired loans is dependent on whether the loan is on nonaccrual status or is a troubled debt restructure. 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 for loan utilizing the discounted cash flow method, or charge-offs for collateral-based impaired loans, or those using observable market pricing.

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The following is a summary of impaired loans at March 31, 2016 (in 000's).

March 31, 2016	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance (1)	Recorded Investment With Allowance (1)	Total Recorded Investment	Related Allowance	Average Recorded Investment (2)	Interest Recognized (2)
Commercial and Business Loans	\$ 5,471	\$ 338	\$ 5,152	\$ 5,490	\$ 1,181	\$ 5,182	\$ 89
Government Program Loans	407	307	101	408	11	368	8
Total Commercial and Industrial	5,878	645	5,253	5,898	1,192	5,550	97
Commercial Real Estate Loans	1,557	—	1,559	1,559	485	1,401	23
Residential Mortgages	3,173	932	2,249	3,181	114	3,616	34
Home Improvement and Home Equity Loans	—	—	—	—	—	—	—
Total Real Estate Mortgage	4,730	932	3,808	4,740	599	5,017	57
Real Estate Construction and Development Loans	11,632	11,661	—	11,661	596	12,090	184
Agricultural Loans	11	11	—	11	—	13	2
Consumer Loans	977	—	977	977	—	813	23
Overdraft Protection Lines	—	—	—	—	—	—	—
Overdrafts	—	—	—	—	—	—	—
Total Installment	977	—	977	977	—	813	23
Total Impaired Loans	\$ 23,228	\$ 13,249	\$ 10,038	\$ 23,287	\$ 2,387	\$ 23,483	\$ 363

(1) The recorded investment in loans includes accrued interest receivable of \$59,000.

(2) Information is based on the three month period ended March 31, 2016.

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The following is a summary of impaired loans at December 31, 2015 (in 000's).

December 31, 2015	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance (1)	Recorded Investment With Allowance (1)	Total Recorded Investment	Related Allowance	Average Recorded Investment (2)	Interest Recognized (2)
Commercial and Business Loans	\$ 4,855	\$ 541	\$ 4,333	\$ 4,874	\$ 530	\$ 2,537	\$ 302
Government Program Loans	327	327	—	327	—	358	29
Total Commercial and Industrial	5,182	868	4,333	5,201	530	2,895	331
Commercial Real Estate Loans	1,243	—	1,243	1,243	477	1,618	74
Residential Mortgages	4,032	1,051	2,999	4,050	158	4,092	185
Home Improvement and Home Equity Loans	—	—	—	—	—	11	—
Total Real Estate Mortgage	5,275	1,051	4,242	5,293	635	5,721	259
Real Estate Construction and Development Loans	12,489	5,340	7,179	12,519	1,282	7,781	820
Agricultural Loans	16	16	—	16	—	22	9
Consumer Loans	650	—	650	650	650	1,043	21
Overdraft Protection Lines	—	—	—	—	—	—	—
Overdrafts	—	—	—	—	—	—	—
Total Installment	650	—	650	650	650	1,043	21
Total Impaired Loans	\$ 23,612	\$ 7,275	\$ 16,404	\$ 23,679	\$ 3,097	\$ 17,462	\$ 1,440

(1) The recorded investment in loans includes accrued interest receivable of \$67,000.

(2) Information is based on the twelve month period ended December 31, 2015.

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

The average recorded investment in impaired loans for the three months ended March 31, 2015 was \$16,901,000. Interest income recognized on impaired loans for the three months ended March 31, 2015 was approximately \$247,000. For impaired nonaccrual loans, interest income recognized under a cash-basis method of accounting was approximately \$149,000 and \$159,000 for the three months ended March 31, 2016 and 2015, respectively.

Troubled Debt Restructurings

In certain 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

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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.

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 illustrates TDR activity for the periods indicated:

(\$ in 000's)	Three Months Ended March 31, 2016			
	Pre-Modification of Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Contracts which Defaulted During Period	Recorded Investment on Defaulted TDRs
Troubled Debt Restructurings				
Commercial and Business Loans	3 \$ 626	\$ 523	—	\$ —
Government Program Loans	1 100	100	—	—
Commercial Real Estate Term Loans	—	—	—	—
Single Family Residential Loans	—	—	—	—
Home Improvement and Home Equity Loans	—	—	—	—
Real Estate Construction and Development Loans	—	—	—	—
Agricultural Loans	—	—	—	—
Consumer Loans	—	—	—	—
Overdraft Protection Lines	—	—	—	—
Total Loans	4 \$ 726	\$ 623	—	\$ —

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(\$ in 000's)	Year Ended March 31, 2015			
	Pre-Modification of Outstanding Contracts Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Contracts which Defaulted During Period	Recorded Investment on Defaulted TDRs
Troubled Debt Restructurings				
Commercial and Business Loans	—\$ —	\$ —	—	\$ —
Government Program Loans	—	—	—	—
Commercial Real Estate Term Loans	—	—	—	—
Single Family Residential Loans	1 258	256	—	—
Home Improvement and Home Equity Loans	—	—	—	—
Real Estate Construction and Development Loans	—	—	—	—
Agricultural Loans	—	—	—	—
Consumer Loans	—	—	—	—
Overdraft Protection Lines	—	—	—	—
Total Loans	1 \$ 258	\$ 256	—	\$ —

The Company makes various types of concessions when structuring TDRs including rate reductions, payment extensions, and forbearance. At March 31, 2016, the Company had 32 restructured loans totaling \$18,591,000 as compared to 29 restructured loans totaling \$18,508,000 at December 31, 2015.

The following tables summarize TDR activity by loan category for the three months ended March 31, 2016 and March 31, 2015 (in 000's).

Three Months Ended March 31, 2016	Commercial and Industrial	Commercial Real Estate	Residential Mortgages	Home Improvement and Home Equity	Real Estate Construction Development	Agricultural	Installment & Other	Total
Beginning balance	\$ 898	\$ 1,243	\$ 3,533	\$ —	—\$ 12,168	\$ 16	\$ 650	\$18,508
Defaults	—	—	—	—	—	—	—	—
Additions	623	—	—	—	—	—	—	623
Principal additions (reductions)	214	314	(853)	—	(536)	(6)	327	(540)
Ending balance	\$ 1,735	\$ 1,557	\$ 2,680	\$ —	—\$ 11,632	\$ 10	\$ 977	\$18,591
Allowance for loan loss	\$ 700	\$ 485	\$ 114	\$ —	—\$ —	\$ —	\$ 596	\$1,895

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Three Months Ended March 31, 2015	Commercial and Industrial	Commercial Real Estate	Residential Mortgages	Home Improvement and Home Equity	Real Estate Construction Development	Agricultural	Installment & Other	Total
Beginning balance	\$ 1,306	\$ 2,713	\$ 4,225	\$ —	—\$ 6,029	\$ 32	\$ 695	\$15,000
Defaults	—	—	—	—	—	—	—	—
Additions	—	—	256	—	—	—	—	256
Principal reductions	(103)	(67)	(199)	—	(79)	(4)	(1)	(453)
Ending balance	\$ 1,203	\$ 2,646	\$ 4,282	\$ —	—\$ 5,950	\$ 28	\$ 694	\$14,803
Allowance for loan loss	\$ 1,024	\$ 455	\$ 175	\$ —	—\$ 40	\$ —	\$ 503	\$2,197

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:

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

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- 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 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.

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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 Company did not carry any loans graded as loss at March 31, 2016 or December 31, 2015.

The following tables summarize the credit risk ratings for commercial, construction, and other non-consumer related loans for March 31, 2016 and December 31, 2015:

March 31, 2016 (in 000's)	Commercial and Industrial	Real Estate			Total
		Commercial Real Estate	Construction and Development	Agricultural	
Grades 1 and 2	\$ 326	\$ —	\$ —	\$ —	\$326
Grade 3	10,007	5,926	—	—	15,933
Grades 4 and 5 – pass	42,540	169,564	103,150	44,767	360,021
Grade 6 – special mention	625	1,608	—	—	2,233
Grade 7 – substandard	5,561	1,224	26,132	—	32,917
Grade 8 – doubtful	—	—	—	—	—
Total	\$ 59,059	\$ 178,322	\$ 129,282	\$ 44,767	\$411,430

December 31, 2015 (in 000's)	Commercial and Industrial	Real Estate			Total
		Commercial Real Estate	Construction and Development	Agricultural	
Grades 1 and 2	\$ 519	\$ —	\$ —	\$ 50	\$569
Grade 3	5,008	5,964	—	—	10,972
Grades 4 and 5 – pass	44,341	173,731	103,607	52,087	373,766
Grade 6 – special mention	946	1,616	—	—	2,562
Grade 7 – substandard	5,012	1,243	26,989	—	33,244
Grade 8 – doubtful	—	—	—	—	—
Total	\$ 55,826	\$ 182,554	\$ 130,596	\$ 52,137	\$421,113

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 March 31, 2016 and December 31, 2015:

(in 000's)	March 31, 2016				December 31, 2015			
	Home		Installment	Total	Home		Installment	Total
	Residential Mortgages	Improvement and Home Equity			Residential Mortgages	Improvement and Home Equity		
Not graded	\$58,850	\$ 750	\$ 24,968	\$84,568	\$47,135	\$ 839	\$ 23,213	\$71,187
Pass	17,783	28	638	18,449	19,466	28	664	20,158
Special Mention	—	—	—	—	—	—	—	—
Substandard	2,255	—	976	3,231	2,210	—	650	2,860
Total	\$78,888	\$ 778	\$ 26,582	\$106,248	\$68,811	\$ 867	\$ 24,527	\$94,205

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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 industrial 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, and the bank maintains appropriate loan-to-value ratios.

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.

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. Although residential real estate markets have improved, they are still distressed on a historical basis, and therefore carry higher risk.

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.

The following summarizes the activity in the allowance for credit losses by loan category for the three months ended March 31, 2016 and 2015 (in 000's).

Three Months Ended	Commercial and Industrial	Real Estate Mortgage	Real Estate Construction Development	Agricultural	Installment & Other	Unallocated	Total
March 31, 2016							
Beginning balance	\$ 1,652	\$ 1,449	\$ 4,629	\$ 655	\$ 1,258	\$ 70	\$ 9,713
Provision (recovery of provision) for credit losses	645	25	(1,387)	(110)	(23)	828	(22)
Charge-offs	(3)	(22)	—	—	—	(7)	(32)
Recoveries	19	7	31	—	2	—	59
Net recoveries	16	(15)	31	—	2	(7)	27

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Ending balance	\$ 2,313	\$ 1,459	\$ 3,273	\$ 545	\$ 1,237	\$ 891	\$9,718
Period-end amount allocated to:							
Loans individually evaluated for impairment	1,193	599	—	—	596	—	2,388
Loans collectively evaluated for impairment	1,120	860	3,273	545	641	891	7,330
Ending balance	\$ 2,313	\$ 1,459	\$ 3,273	\$ 545	\$ 1,237	\$ 891	\$9,718

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Three Months Ended	Commercial and Industrial	Real Estate Mortgage	Real Estate Construction and Development	Agricultural	Installment & Other	Unallocated	Total
March 31, 2015							
Beginning balance	\$ 1,219	\$ 1,653	\$ 6,278	\$ 481	\$ 293	\$ 847	\$ 10,771
Provision (recovery of provision) for credit losses	834	84	(99)	12	466	(838)	459
Charge-offs	(215)	—	—	—	—	(3)	(218)
Recoveries	237	7	30	—	2	2	278
Net charge-offs	22	7	30	—	2	(1)	60
Ending balance	\$ 2,075	\$ 1,744	\$ 6,209	\$ 493	\$ 761	\$ 8	\$ 11,290
Period-end amount allocated to:							
Loans individually evaluated for impairment	1,024	630	40	—	503	—	2,197
Loans collectively evaluated for impairment	1,051	1,114	6,169	493	258	8	9,093
Ending balance	\$ 2,075	\$ 1,744	\$ 6,209	\$ 493	\$ 761	\$ 8	\$ 11,290

The following summarizes information with respect to the loan balances at March 31, 2016 and 2015.

(in 000's)	March 31, 2016			March 31, 2015		
	Loans Individually Evaluated for Impairment	Loans Collectively Evaluated for Impairment	Total Loans	Loans Individually Evaluated for Impairment	Loans Collectively Evaluated for Impairment	Total Loans
Commercial and Business Loans	\$5,490	\$ 51,522	\$57,012	\$ 1,878	\$ 57,956	\$59,834
Government Program Loans	408	1,639	2,047	388	1,493	1,881
Total Commercial and Industrial	5,898	53,161	59,059	2,266	59,449	61,715
Commercial Real Estate Loans	1,559	176,763	178,322	2,646	155,780	158,426
Residential Mortgage Loans	3,181	75,707	78,888	4,568	72,499	77,067
Home Improvement and Home Equity Loans	—	778	778	42	1,044	1,086
Total Real Estate Mortgage	4,740	253,248	257,988	7,256	229,323	236,579
Real Estate Construction and Development Loans	11,661	117,621	129,282	6,287	141,005	147,292
Agricultural Loans	11	44,756	44,767	29	34,718	34,747
Installment Loans	977	25,605	26,582	1,314	10,598	11,912
Total Loans	\$23,287	\$ 494,391	\$517,678	\$17,152	\$ 475,093	\$492,245

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4. Deposits

Deposits include the following:

(in 000's)	March 31, December 31,	
	2016	2015
Noninterest-bearing deposits	\$ 261,827	\$ 262,168
Interest-bearing deposits:		
NOW and money market accounts	235,946	226,886
Savings accounts	66,434	63,592
Time deposits:		
Under \$250,000	61,958	58,122
\$250,000 and over	11,162	11,037
Total interest-bearing deposits	375,500	359,637
Total deposits	\$ 637,327	\$ 621,805

Total brokered deposits included in time deposits above \$12,146 \$ 8,546

5. Short-term Borrowings/Other Borrowings

At March 31, 2016, the Company had collateralized lines of credit with the Federal Reserve Bank of San Francisco totaling \$259,645,000, as well as Federal Home Loan Bank (FHLB) lines of credit totaling \$2,642,000. At March 31, 2016, the Company had an uncollateralized line of credit with Pacific Coast Bankers Bank ("PCBB") totaling \$10,000,000 and a Fed Funds line of \$20,000,000 with Zions First National Bank. All lines of credit are on an "as available" basis and can be revoked by the grantor at any time. These lines of credit have interest rates that are generally tied to the Federal Funds rate or are indexed to short-term U.S. Treasury rates or LIBOR. FHLB advances are collateralized by the Company's stock in the FHLB, investment securities, and certain qualifying mortgage loans. As of March 31, 2016, \$2,795,000 in investment securities at FHLB were pledged as collateral for FHLB advances. Additionally, \$403,872,000 in secured and unsecured loans were pledged at March 31, 2016, as collateral for borrowing lines with the Federal Reserve Bank totaling \$259,645,000. At March 31, 2016, the Company had no outstanding borrowings.

At December 31, 2015, the Company had collateralized lines of credit with the Federal Reserve Bank of San Francisco totaling \$302,456,000, as well as Federal Home Loan Bank ("FHLB") lines of credit totaling \$2,854,000. At December 31, 2015, the Company had an uncollateralized line of credit with Pacific Coast Bankers Bank ("PCBB") totaling \$10,000,000. 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 the Company's stock in the FHLB, investment securities, and certain qualifying mortgage loans. As of December 31, 2015, \$3,023,000 in investment securities at FHLB were pledged as collateral for FHLB advances. Additionally, \$444,596,000 in secured and unsecured loans were pledged at December 31, 2015, as collateral for used and unused borrowing lines with the Federal Reserve Bank totaling \$302,456,000. All lines of credit are on an "as available" basis and can be revoked by the grantor at any time. At December 31, 2015, the Company had no outstanding borrowings.

6. Supplemental Cash Flow Disclosures

Three
months
ended
March 31,

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(in 000's)	2016	2015
Cash paid during the period for:		
Interest	\$331	\$315
Income taxes	\$210	\$—
Noncash investing activities:		
Loans transferred to foreclosed assets	\$158	\$—
Unrealized gain on securities	\$59	\$120

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7. Common Stock Dividend

On March 22, 2016, the Company's Board of Directors declared a one-percent (1%) stock dividend on the Company's outstanding common stock. Based upon the number of outstanding common shares on the record date of April 4, 2016, 160,492 additional shares were issued to shareholders on April 15, 2016. Because the stock dividend was considered a "small stock dividend," approximately \$786,519 was transferred from retained earnings to common stock based upon the \$4.90 closing price of the Company's common stock on the declaration date of March 22, 2016. There were no fractional shares paid. Except 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.

8. Net Income per Common 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:

	Three months ended March 31,	
	2016	2015
Net income (000's)	\$1,769	\$ 1,228
Weighted average shares issued	16,211,806	16,211,898
Add: dilutive effect of stock options	3,154	1,941
Weighted average shares outstanding adjusted for potential dilution	16,215,052	16,213,839
Basic earnings per share	\$0.11	\$ 0.08
Diluted earnings per share	\$0.11	\$ 0.08
Anti-dilutive stock options excluded from earnings per share calculation	20,000	123,000

9. Taxes on Income

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 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. At March 31, 2016 and December 31, 2015, the Company had no recorded valuation allowance.

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 California 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 returns for 2009 and 2010 were filed in 2014 and 2015, respectively. The amended returns for 2011 and 2012 will be filed during 2016 once the Franchise Tax Board accepts the 2009 and 2010 amended returns. The Company's policy is to recognize any interest or penalties related to uncertain tax positions in income tax expense.

10. Junior Subordinated Debt/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

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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. The Company may redeem the junior subordinated debentures at anytime at par.

During August 2015, the Bank purchased \$3.0 million of the Company's junior subordinated debentures related to the Company's trust preferred securities at a fair value discount of 40%. Subsequently, in September 2015, the Company purchased those shares from the Bank and canceled \$3.0 million in par value of the junior subordinated debentures, realizing a \$78,000 gain on redemption. The contractual principal balance of the Company's debentures relating to its trust preferred securities is \$12.0 million as of March 31, 2016.

The fair value guidance generally permits the measurement of selected eligible financial instruments at fair value at specified election dates. Effective January 1, 2008, the Company elected the fair value option for its junior subordinated debt issued under USB Capital Trust II. The Company believes the election of fair value accounting for the junior subordinated debentures better reflects the true economic value of the debt instrument on the balance sheet. The rate paid on the junior subordinated debt issued under USB Capital Trust II is 3-month LIBOR plus 129 basis points, and is adjusted quarterly.

At March 31, 2016 the Company performed a fair value measurement analysis on its junior subordinated debt using a cash flow 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 thirty-year 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. We believe the 6.49% discount rate used represents what a market participant would consider under the circumstances based on current market assumptions. At March 31, 2016, the total cumulative gain recorded on the debt is \$4,572,000.

The fair value calculation performed at March 31, 2016 resulted in a pretax gain adjustment of \$358,000 (\$211,000, net of tax) for the three months ended March 31, 2016, compared to a pretax loss adjustment of \$125,000 (\$73,000, net of tax) for the three months ended March 31, 2015. Fair value gains and losses are reflected as a component of noninterest income on the consolidated statement of income.

11. Fair Value Measurements and Disclosure

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:

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March 31, 2016

(in 000's)	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	\$ 125,489	\$ 125,489	\$ 125,489	\$ —	—
Interest-bearing deposits	1,530	1,530	—	1,530	—
Investment securities	44,394	44,394	3,854	40,540	—
Loans	508,571	504,689	—	—	504,689
Accrued interest receivable	2,741	2,741	—	2,741	—
Financial Liabilities:					
Deposits:					
Noninterest-bearing	261,827	261,827	261,827	—	—
NOW and money market	235,946	235,946	235,946	—	—
Savings	66,434	66,434	66,434	—	—
Time deposits	73,120	73,461	—	—	73,461
Total deposits	637,327	637,668	564,207	—	73,461
Junior subordinated debt	7,948	7,948	—	—	7,948
Accrued interest payable	33	33	—	33	—

(in 000's)	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	\$ 125,751	\$ 125,751	\$ 125,751	\$ —	—
Interest-bearing deposits	1,528	1,528	—	1,528	—
Investment securities	30,893	30,893	3,812	27,081	—
Loans	505,663	503,047	—	—	503,047
Accrued interest receivable	2,220	2,220	—	2,220	—
Financial Liabilities:					
Deposits:					
Noninterest-bearing	262,168	262,168	262,168	—	—
NOW and money market	226,886	226,886	226,886	—	—
Savings	63,592	63,592	63,592	—	—
Time deposits	69,159	69,031	—	—	69,031
Total deposits	621,805	621,677	552,646	—	69,031
Junior subordinated debt	8,300	8,300	—	—	8,300
Accrued interest payable	29	29	—	29	—

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 Company's Level 1 financial assets consist of money market funds and highly liquid mutual funds for which fair values are based on quoted market prices. The Company's Level 2 financial assets include highly liquid debt instruments of U.S. government agencies, collateralized mortgage obligations, and debt obligations of states and political subdivisions, whose fair

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values are obtained from readily-available pricing sources for the identical or similar underlying security that may, or may not, be actively traded. The Company's Level 3 financial assets include certain impaired loans, other real estate owned, goodwill, and intangible assets where the assumptions may be made by us or third parties about assumptions that market participants would use in pricing the asset or liability. From time to time, the Company recognizes transfers between Level 1, 2, and 3 when a change in circumstances warrants a transfer. There were no significant transfers in or out of Level 1 and Level 2 fair value measurements during the three months ended March 31, 2016.

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 consolidated 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. The allowance for loan loss is considered to be a reasonable estimate of loan discount for credit quality concerns.

Impaired Loans - Fair value measurements for collateral dependent impaired loans are performed pursuant to authoritative accounting guidance and are based upon either collateral values supported by appraisals and observed market prices. Collateral dependent loans are measured for impairment using the fair value of the collateral. Changes are recorded directly as an adjustment to current earnings.

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 – Fair values for transaction and savings accounts are equal to the respective amounts payable on demand (i.e., carrying amounts). 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. Cash flows are 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 these 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.

Off-Balance Sheet Instruments - Off-balance sheet instruments consist of commitments to extend credit, standby letters of credit and derivative contracts. 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

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counterparties' credit standing. There was no material difference between the contractual amount and the estimated fair value of commitments to extend credit at March 31, 2016 and December 31, 2015.

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 sheets and results of operations.

The following table provides a description of the valuation technique, unobservable input, and qualitative information about the unobservable inputs for the Company's assets and liabilities classified as Level 3 and measured at fair value on a recurring basis at March 31, 2016 and 2015:

March 31, 2016				December 31, 2015			
Financial Instrument	Valuation Technique	Unobservable Input	Weighted Average	Financial Instrument	Valuation Technique	Unobservable Input	Weighted Average
Junior Subordinated Debt	Discounted cash flow	Discount Rate	6.49%	Junior Subordinated Debt	Discounted cash flow	Discount Rate	6.82%

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).

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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 March 31, 2016 (in 000's):

Description of Assets	March 31, 2016	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	\$14,370	\$ —	\$ 14,370	\$ —
U.S. Government collateralized mortgage obligations	26,170	—	26,170	—
Mutual Funds	3,854	3,854	—	—
Total AFS securities	\$44,394	\$ 3,854	\$ 40,540	\$ —
Impaired loans (1):				
Commercial and industrial	—	—	—	—
Real estate mortgage	—	—	—	—
RE construction & development	—	—	—	—
Agricultural	—	—	—	—
Installment/Other	—	—	—	—
Total impaired loans	\$—	\$ —	\$ —	\$ —
Other real estate owned (1)	—	—	—	—
Total	\$44,394	\$ 3,854	\$ 40,540	\$ —

Description of Liabilities	March 31, 2016	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)	\$ 7,948	—	—	\$ 7,948
Total	\$ 7,948	—	—	\$ 7,948

(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, 2015 (in 000's):

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Description of Assets	December 31, 2015	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	\$ 10,123	\$ —	\$ 10,123	\$ —
U.S. Government collateralized mortgage obligations	16,958	—	16,958	—
Mutual Funds	3,812	3,812	—	—
Total AFS securities	30,893	3,812	27,081	\$ —
Impaired Loans (1):				
Commercial and industrial	—	—	—	—
Real estate mortgage	—	—	—	—
RE construction & development	—	—	—	—
Agricultural	—	—	—	—
Installment/Other	—	—	—	—
Total impaired loans	\$ —	\$ —	\$ —	\$ —
Other real estate owned (1)	9,208	—	—	9,208
Total	\$ 40,101	\$ 3,812	\$ 27,081	\$ 9,208

Description of Liabilities	December 31, 2015	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)	\$ 8,300	\$ —	—	\$ 8,300
Total	\$ 8,300	\$ —	—	\$ 8,300

(1) Nonrecurring

(2) Recurring

The Company did not record a write-down on other real estate owned during the three months ended March 31, 2016 and recorded a \$188,000 write-down on other real estate owned for the year ended December 31, 2015.

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, 2015. The Company had no assets measured at fair value on a non-recurring basis at March 31, 2016 (in 000's).

December 31, 2015

Financial Instrument	Fair Value	Valuation Technique	Unobservable Input Range, Weighted Average
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Other real estate owned:

Real estate construction \$9,208 Discounted cash flow Discount rate 1%-10%, 8.49%

The following tables provide a reconciliation of assets and liabilities at fair value using significant unobservable inputs (Level 3) on a recurring basis during the three months ended March 31, 2016 and 2015 (in 000's):

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	Three Months Ended March 31, 2016 Junior Subordinated Debt	Three Months Ended March 31, 2015 Junior Subordinated Debt
Reconciliation of Liabilities:		
Beginning balance	\$ 8,300	\$ 10,115
Total gains (losses) included in earnings	358	(125)
Capitalized interest	(710)	248
Ending balance	\$ 7,948	\$ 10,238
The amount of total gains (losses) for the period included in earnings attributable to the change in unrealized gains or losses relating to liabilities still held at the reporting date	\$ 358	\$ (125)

12. Goodwill and Intangible Assets

At March 31, 2016, the Company had goodwill in the amount of \$4,488,000 in connection with various business combinations and purchases. This amount was unchanged from the balance of \$4,488,000 at December 31, 2015. While goodwill is not amortized, the Company does conduct periodic impairment analysis on goodwill at least annually or more often as conditions require.

Goodwill: The largest component of goodwill is related to the Legacy Bank merger (Campbell reporting unit) completed during February 2007 and totaled approximately \$2.9 million at March 31, 2016. The Company completed a "Step 0" analysis for the Campbell reporting unit as of March 31, 2016 and March 31, 2015, with no goodwill impairment.

Under the Step 0 analysis, the Company has the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events or circumstances, the Company determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test is unnecessary. Determining the fair value involves a significant amount of judgment, including estimates of changes in revenue growth, changes in discount rates, competitive forces within the industry, and other specific industry and market valuation conditions. Based on the results of the Step 0 impairment analysis at March 31, 2016, the Company concluded that the fair value of the reporting unit exceeds its carrying value. Therefore, goodwill was not impaired.

Core Deposit Intangibles: The core deposit intangible asset related to the Legacy Bank merger, which totaled \$3.0 million at the time of merger, was amortized over an estimated life of approximately seven years. At March 31, 2016, there was no remaining carrying value of the core deposit intangible related to the Legacy Bank merger. The Company recognized no amortization expense related to the Campbell operating unit during the three months ended March 31, 2016 and March 31, 2015. At March 31, 2016, there was no remaining carrying value of core deposit intangible related to the Taft branch acquisitions completed in April 2004.

13. 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. Unrecognized 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 consolidated financial statements were issued.

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Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

Certain matters discussed or incorporated by reference in this Quarterly Report of Form 10-Q 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 provision 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 agreements 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. For additional information concerning risks and uncertainties related to the Company and its operations, please refer to the Company's Annual Report on Form 10-K for the year ended December 31, 2015.

United Security Bancshares (the "Company" or "Holding 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. United Security Bank (the "Bank") is a wholly-owned bank subsidiary of the Company and was formed in 1987. References to the Company are references to United Security Bancshares (including the Bank). References to the Bank are to United Security Bank, while references to the Holding Company are to the parent only, United Security Bancshares. The Company currently has eleven banking branches, which provide financial services in Fresno, Madera, Kern, and Santa Clara counties in the state of California.

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. (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.)

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

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as to future regulatory approvals, the DBO and the Federal Reserve have been approving the Bank's quarterly 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 since June 2014. 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.)

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 the 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 must also be considered in the planning process to mitigate risk and allow for growth. Net interest income has increased between the three months ended March 31, 2016 and 2015, totaling \$6,611,000 for the three months ended March 31, 2016 as compared to \$6,224,000 for the three months ended March 31, 2015. The increase in net interest income between 2015 and 2016 was primarily the result of reinvestment of low yielding overnight investments into the loan portfolio.

Average interest-earning assets increased approximately \$51,773,000 between the three months ended March 31, 2016 and 2015. Components of the \$51,773,000 increase in average earning assets between 2015 and 2016 included an increase of \$35,795,000 in loans and an increase of \$25,063,000 in overnight funds sold to the Federal Reserve Bank. During the past year, the Company's cost of interest-bearing liabilities has remained constant, with the average cost of interest-bearing liabilities unchanged at 0.36% for the three months ended March 31, 2015, and 0.36% for the three months ended March 31, 2016.

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 3/31/2016	YTD Average 12/31/15	YTD Average 3/31/2015
Loans	77.91%	79.68%	78.67%
Investment securities available for sale	5.99%	6.56%	8.05%
Interest-bearing deposits in other banks	0.24%	0.25%	0.26%
Interest-bearing deposits in FRB	15.86%	13.51%	13.02%
Total interest-earning assets	100.00%	100.00%	100.00%
NOW accounts	22.13%	21.91%	22.08%
Money market accounts	39.03%	38.15%	36.80%
Savings accounts	17.61%	17.03%	16.93%
Time deposits	19.02%	20.33%	21.41%
Subordinated debentures	2.21%	2.58%	2.78%
Total interest-bearing liabilities	100.00%	100.00%	100.00%

Since the Bank primarily conducts banking operations in California's Central Valley, its operations and cash flows are subject to changes in the economic condition of the Central Valley. Our business results are dependent in large part upon the business activity, population, income levels, deposits and real estate activity in the Central Valley, and declines in economic conditions can have adverse material effects upon the Bank. In addition, the Central Valley

remains largely dependent on agriculture. A downturn in agriculture and agricultural related business could indirectly and adversely affect the Company as many borrowers and customers are involved in, or are impacted to some extent, by the agricultural industry. While a great number of our borrowers are not directly involved in agriculture, they would likely be impacted by difficulties in the agricultural industry since many jobs in our market areas are ancillary to the regular production, processing, marketing and sale of agricultural commodities. The state of California is currently experiencing the worst drought in recorded history, and, of course, it is not possible to predict the potential impact on businesses and consumers located in the Company's market areas or the duration of the drought.

The residential real estate markets in the five county region from Merced to Kern has strengthened since 2013 and that trend has continued into the first quarter of 2016. The severe declines in residential construction and home prices that began in 2008

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have ended and home prices are now rising on a year-over-year basis. The sustained period of double-digit price declines from 2008–2011 adversely impacted the Company’s operations and increased the levels of nonperforming assets, increased expenses related to foreclosed properties, and decreased profit margins. As the Company continues its business development and expansion efforts throughout its market areas, it will also maintain its commitment to the reduction of nonperforming assets and provision of options for borrowers experiencing difficulties. Those options include combinations of rate and term concessions, as well as forbearance agreements with borrowers. Median sales prices and housing start numbers improved in the five county region from Merced to Kern between June 2013 to March 2016. Total nonperforming loans decreased by over \$241,000 during the three months ended March 31, 2016, totaling \$18,980,000 at March 31, 2016 as compared to \$19,221,000 reported at December 31, 2015.

As a result of improvements in the economy, the Company has experienced significant increases in the loan portfolio between 2015 and 2016. During the three months ended March 31, 2016, the Company experienced increases in commercial and industrial loans, real estate mortgage loans, and installment loans but experienced decreases in real estate construction and development loans and agricultural loans, compared to the same period ended March 31, 2015. Loans increased \$2,360,000 between December 31, 2015 and March 31, 2016, and increased \$25,433,000 between March 31, 2015 and March 31, 2016. Commercial and industrial loans increased \$3,233,000 between December 31, 2015 and March 31, 2016 and decreased \$2,656,000 between March 31, 2015 and March 31, 2016. Real estate mortgage loans increased \$5,756,000 between December 31, 2015 and March 31, 2016, and \$21,409,000 between March 31, 2015 and March 31, 2016. The increases in real estate mortgage loans are partially due to residential mortgage loan pools purchased in February 2015 and March 2016. Agricultural loans decreased \$7,370,000 between December 31, 2015 and March 31, 2016 and increased \$10,020,000 between March 31, 2015 and March 31, 2016. Commercial real estate loans (a component of real estate mortgage loans) have remained as a significant portion of total loans over the past year having increased in balance while decreasing slightly as a portion of the total loan portfolio. Commercial real estate loans amounted to 34.45%, 35.43%, and 32.18%, of the total loan portfolio at March 31, 2016, December 31, 2015, and March 31, 2015, respectively. 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. These loans are generally 30-year amortizing loans with maturities of between three and five years. Residential mortgages totaled \$78,888,000 or 15.24% of the portfolio at March 31, 2016, \$68,811,000, or 13.35% of the portfolio at December 31, 2015, and \$77,067,000 or 15.66% of the portfolio at March 31, 2015. The Company held no loan participation purchases at March 31, 2015, December 31, 2015 or March 31, 2016. Loan participations sold increased from \$6,123,000, or 1.24%, of the portfolio at March 31, 2015, to \$29,025,000, or 5.6% of the portfolio, at December 31, 2015, and decreased to \$28,897,000, or 5.6% of the portfolio, at March 31, 2016.

Although market rates of interest are at historically low levels, the Company’s disciplined deposit pricing efforts have helped keep the Company’s cost of funds low. The Company’s net interest margin decreased to 4.11% for the three months ended March 31, 2016, when compared to 4.25% for the three months ended March 31, 2015. The net interest margin has declined due to declines in the the loan portfolio yield, partially offset by increases in yields on investment securities and 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 5.31% during the three months ended March 31, 2016, as compared to 5.46% for the three months ended March 31, 2015. The increase in the Company’s cost of funds over the past year has mitigated the impact of declining yields on earning assets. The Company’s average cost of funds remained at 0.36% for the three months ended March 31, 2016, as compared to 0.36% for the three months ended March 31, 2015. Since the Company does not intend to increase its current level of brokered deposits, the level of brokered deposits is expected to remain relatively constant at least in the short-term. Currently CDARs reciprocal deposits are the only brokered deposits in the Company. CDARs reciprocal deposits are preferred by some depositors.

Total noninterest income of \$1,561,000 reported for the three months ended March 31, 2016 increased \$640,000 or 69.49% as compared to the three months ended March 31, 2015. This increase included a gain of \$358,000 on the fair value of a financial liability as compared to a loss of \$125,000 for the same period in 2015. Noninterest income continues to be driven by customer service fees, which increased slightly to \$926,000 for the three months ended March 31, 2016 as compared to \$833,000 for the three months ended March 31, 2015.

Noninterest expense increased approximately \$592,000 or 12.57% between the three months ended March 31, 2015 and March 31, 2016. The increase experienced during the three months ended March 31, 2016, was primarily the result of increases of \$159,000 in employee salary and benefit expenses, \$157,000 in occupancy expense, and \$141,000 in professional fees.

On March 22, 2016, the Company's Board of Directors declared a one-percent (1%) quarterly stock dividend on the Company's outstanding common stock. The Company believes that, given the current uncertainties in the economy, it is prudent to retain capital and better position the Company for future growth opportunities. Based upon the number of outstanding common shares

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on the record date of April 4, 2016, an additional 160,492 shares 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.

The Company has sought to maintain a strong, yet conservative balance sheet while continuing to reduce the level of nonperforming assets and improve liquidity during the three months ended March 31, 2016. Total assets increased approximately \$16,147,000 during the three months ended March 31, 2016, including increases of \$13,501,000 in investment securities, \$5,451,000 in overnight investments with the Federal Reserve Bank, and \$2,908,000 in net loans. Total deposits increased \$15,522,000, including increases of \$9,060,000 in NOW and money market accounts and \$3,961,000 in time deposits, partially offset by a decrease of \$341,000 in noninterest-bearing deposits during the three months ended March 31, 2016. Average loans comprised approximately 77.91% and 78.67% of overall average earning assets during the three months ended March 31, 2016 and March 31, 2015, respectively.

Nonperforming assets, which are primarily related to the real estate loan and other real estate owned portfolio, remained high during the three months ended March 31, 2016, but decreased \$907,000 from a balance of \$32,094,000 at December 31, 2015 to a balance of \$31,187,000 at March 31, 2016. Nonaccrual loans, totaling \$8,353,000 at March 31, 2016, increased \$160,000 from the balance of \$8,193,000 reported at December 31, 2015. 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 \$325,000 during the three months ended March 31, 2016 to a balance of \$23,287,000 at March 31, 2016. Other real estate owned through foreclosure decreased to a balance of \$12,207,000 at March 31, 2016 as compared to a balance of \$12,873,000 at December 31, 2015. Nonperforming assets as a percentage of total assets decreased from 4.42% at December 31, 2015 to 4.20% at March 31, 2016.

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

(in 000's)	March 31, 2016	December 31, 2015	March 31, 2015
Provision (recovery of provision) for credit losses during period	\$(22)	\$(845)	\$459
Allowance as % of nonperforming loans	51.20%	50.53 %	67.61%
Nonperforming loans as % total loans	3.67 %	3.73 %	3.39 %
Restructured loans as % total loans	3.59 %	3.59 %	3.01 %

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, while working with borrowers to find more options, including loan restructures, to work through these difficult economic times. Restructured loan balances are comprised of 32 loans totaling \$18,591,000 at March 31, 2016, compared to 29 loans totaling \$18,508,000 at December 31, 2015.

The Company recorded a recovery of provision of \$22,000 to the allowance for credit losses during the three months ended March 31, 2016, as compared to a provision of \$459,000 for the three months ended March 31, 2015. Net loan and lease recoveries during the three months ended March 31, 2016 totaled \$27,000 as compared to net recoveries of \$60,000 for the three months ended March 31, 2015. The Company charged-off, or had partial charge-offs on, 5 loans during the three months ended March 31, 2016, as compared to 2 loans during the same period ended March 31, 2015, and 9 loans during the year ended December 31, 2015. The annualized percentage net recoveries to average loans

were 0.02% and 0.05% for the three months ended March 31, 2016 and 2015, respectively, as compared to charge-offs of 0.21% for the year ended December 31, 2015. The Company's net loans increased from \$492,560,000 at March 31, 2015 to \$518,289,000 at March 31, 2016, however the Company did not record a provision to the allowance for credit losses during that period. Management evaluates its estimate of the allowance for credit losses quarterly and believes it adequately covers the estimated losses inherent in the loan portfolio.

Deposits increased by \$15,522,000 during the three months ended March 31, 2016, primarily due to increases of \$15,863,000 experienced in interest bearing deposits, offset by decreases of \$341,000 in noninterest bearing deposits. The Company continues to maintain a low reliance on brokered deposits, while maintaining sufficient liquidity. Currently, the Company does not utilize wholesale funding sources. Brokered deposits totaled \$12,146,000 or 1.91% of total deposits at March 31, 2016, as

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compared to \$8,546,000, or 1.37%, of total deposits at December 31, 2015, and \$13,009,000, or 2.25%, of total deposits at March 31, 2015.

The cost of the Company's subordinated debentures issued by USB Capital Trust II has remained low as market rates have remained low during the first quarter of 2016. With pricing at 3-month-LIBOR plus 129 basis points, the effective cost of the subordinated debt was 1.93% at March 31, 2016, as compared to 1.90% at December 31, 2015. Pursuant to fair value accounting guidance, the Company has recorded \$358,000 in pretax fair value gain on its junior subordinated debt during the three months ended March 31, 2016, bringing the total cumulative gain recorded on the debt to \$4,572,000 at March 31, 2016.

The Company continues to emphasize relationship banking and core deposit growth, and has focused greater attention on its market area of Fresno, Madera, and Kern Counties, as well as Campbell, in Santa Clara County. The San Joaquin Valley and other California markets continue to exhibit weak demand for construction lending and commercial lending from small and medium size businesses, as commercial and residential real estate markets have shown improvements but still remain depressed, compared with prior years.

Results of Operations

On a year-to-date basis, the Company reported net income of \$1,769,000 or \$0.11 per share (\$0.11 diluted) for the three months ended March 31, 2016, as compared to \$1,228,000 or \$0.08 per share (\$0.08 diluted) for the same period in 2015. The Company's return on average assets was 0.98% for the three months ended March 31, 2016, as compared to 0.74% for the three months ended March 31, 2015. The Company's return on average equity was 7.82% for the three months ended March 31, 2016, as compared to 5.94% for the three months ended March 31, 2015.

Net Interest Income

Net interest income totaled \$6,611,000 for the three months ended March 31, 2016, representing an increase of \$387,000, or 6.22%, when compared to the \$6,224,000 reported for the same period of the previous year.

The Company's year-to-date net interest margin, as shown in Table 1, decreased to 4.11% for the three months ended March 31, 2016 from 4.25% for the same period ended March 31, 2015, an decrease of 14 basis points (100 basis points = 1%) between the two periods. While average market rates of interest have remained level between the three months ended March 31, 2016 and 2015, the Company's earning asset mix has improved with large increase in loan balances which have positively impacted the net margin between the two periods. The prime rate was raised from its long-standing rate of 3.25% to 3.50% in December 2015 and is expected to see further increases during 2016.

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Table 1. Distribution of Average Assets, Liabilities and Shareholders' Equity:

Interest rates and Interest Differentials

Three months ended March 31, 2016 and 2015

(dollars in 000's)	2016				2015			
	Average Balance	Interest	Yield/Rate (2)		Average Balance	Interest	Yield/Rate (2)	
Assets:								
Interest-earning assets:								
Loans and leases (1)	\$502,576	\$6,631	5.31 %		\$466,781	\$6,279	5.46 %	
Investment Securities – taxable (3)	38,664	189	1.97 %		47,756	214	1.82 %	
Interest-bearing deposits in other banks	1,529	2	0.53 %		1,522	2	0.53 %	
Interest-bearing deposits in FRB	102,320	124	0.49 %		77,257	46	0.24 %	
Total interest-earning assets	645,089	\$6,946	4.33 %		593,316	\$6,541	4.47 %	
Allowance for credit losses	(9,694)				(10,821)			
Noninterest-earning assets:								
Cash and due from banks	22,842				21,209			
Premises and equipment, net	10,780				11,458			
Accrued interest receivable	1,922				1,493			
Other real estate owned	12,920				14,010			
Other assets	37,497				42,221			
Total average assets	\$721,356				\$672,886			
Liabilities and Shareholders' Equity:								
Interest-bearing liabilities:								
NOW accounts	\$82,813	\$25	0.12 %		\$79,909	\$26	0.13 %	
Money market accounts	146,030	139	0.38 %		133,209	105	0.32 %	
Savings accounts	65,888	37	0.23 %		61,277	42	0.28 %	
Time deposits	71,162	76	0.43 %		77,497	86	0.45 %	
Other borrowings	—	—	0.00 %		—	—	0.00 %	
Junior subordinated debentures	8,268	58	2.82 %		10,079	58	2.33 %	
Total interest-bearing liabilities	374,161	\$335	0.36 %		361,971	\$317	0.36 %	
Noninterest-bearing liabilities:								
Noninterest-bearing checking	249,855				219,707			
Accrued interest payable	74				80			
Other liabilities	6,577				7,251			
Total Liabilities	630,667				589,009			
Total shareholders' equity	90,689				83,877			
Total average liabilities and shareholders' equity	\$721,356				\$672,886			
Interest income as a percentage of average earning assets			4.32 %				4.47 %	
Interest expense as a percentage of average earning assets			0.21 %				0.22 %	
Net interest margin			4.11 %				4.25 %	

(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 \$49,000 and \$110,000 for the three months ended March 31, 2016 and 2015, respectively.

(2) Interest income/expense is divided by actual number of days in the period times 365 days in the yield calculation

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- (3) Yields on investments securities are calculated based on average amortized cost balances rather than fair value, as changes in fair value are reflected as a component of shareholders' equity.

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 periods indicated.

Table 2. Rate and Volume Analysis

(in 000's)	Increase (decrease) in the three months ended March 31 compared to March 31, 2015		
	Total	Rate	Volume
Increase (decrease) in interest income:			
Loans and leases	\$352	\$(160)	\$ 512
Investment securities available for sale	(25)	17	(42)
Interest-bearing deposits in other banks	—	—	—
Interest-bearing deposits in FRB	78	44	34
Total interest income	405	(99)	504
Increase (decrease) in interest expense:			
Interest-bearing demand accounts	33	22	11
Savings and money market accounts	(5)	(8)	3
Time deposits	(10)	(4)	(6)
Other borrowings	—	—	—
Subordinated debentures	—	11	(11)
Total interest expense	18	21	(3)
Increase in net interest income	\$387	\$(120)	\$ 507

For the three months ended March 31, 2016, total interest income increased approximately \$405,000 or 6.19% as compared to the three months ended March 31, 2015. Earning asset volumes for loans and leases increased \$35,795,000 on average. Available for sale investment securities decreased \$9,092,000 while overnight investments with the FRB increased \$25,063,000 between the two periods. The average rates on loans decreased 15 basis points between the two periods, and the average rate on investment securities increased approximately 15 basis points during the three months ended March 31, 2016 as compared to the same period of 2014.

For the three months ended March 31, 2016, total interest expense increased approximately \$18,000, or 5.68% as compared to the three months ended March 31, 2015. Between those two periods, average interest-bearing liabilities increased by \$12,190,000, while the average rates paid on these liabilities remained unchanged.

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. Management believes its estimate of the allowance for credit losses adequately covers estimated losses inherent in the loan portfolio and, based on the condition of the loan portfolio, management believes the allowance is sufficient to cover risk elements in the loan portfolio. For the three months ended March 31, 2016, the recovery of provision for the allowance for credit losses was \$22,000 as compared to a provision of \$459,000 for the three months ended March 31,

2015.

The provision allocated during the three months ended March 31, 2016 brought the allowance to 1.88% of outstanding loan balances at March 31, 2016, as compared to 1.88% of outstanding loan balances at December 31, 2015, and 2.29% at March 31, 2015.

Table 3. Changes in Noninterest Income

The following table sets forth the amount and percentage changes in the categories presented for the three months ended March 31, 2016 and 2015:

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(in 000's)	Three Months Ended March 31, 2016	Three Months Ended March 31, 2015	Amount of Change	Percent Change	
Customer service fees	\$ 926	\$ 833	\$ 93	11.16	%
Increase in cash surrender value of BOLI/COLI	131	128	3	2.34	%
Gain (loss) on fair value of financial liability	358	(125)	483	(386.40)	%
Other	146	85	61	71.76	%
Total noninterest income	\$ 1,561	\$ 921	\$ 640	69.49	%

Noninterest income for the three months ended March 31, 2016 increased \$640,000 or 69.49% when compared to the same period of 2015. Customer service fees, the primary component of noninterest income, increased \$93,000 or 11.16% between the two periods presented. The increase in noninterest income of \$640,000 between the two periods is primarily the result of a gain recorded on the fair value of a financial liability for the three months ended March 31, 2016 as compared to a loss on the fair value of a financial liability recorded for the same period in 2015. The change in the fair value of financial liability was primarily caused by fluctuations in the LIBOR yield curve.

Noninterest Expense

The following table sets forth the amount and percentage changes in the categories presented for the three months ended March 31, 2016 and 2015:

Table 4. Changes in Noninterest Expense

(in 000's)	Three Months Ended March 31, 2016	Three Months Ended March 31, 2015	Amount of Change	Percent Change	
Salaries and employee benefits	\$ 2,590	\$ 2,431	\$ 159	6.54	%
Occupancy expense	1,097	940	157	16.70	%
Data processing	59	31	28	90.32	%
Professional fees	489	348	141	40.52	%
FDIC/DFI insurance assessments	256	246	10	4.07	%
Director fees	70	56	14	25.00	%
Correspondent bank service charges	20	19	1	5.26	%
Loss on California tax credit partnership	37	30	7	23.33	%
Net cost on operation of OREO	116	68	48	70.59	%
Other	566	539	27	5.01	%
Total expense	\$ 5,300	\$ 4,708	\$ 592	12.57	%

Noninterest expense increased \$592,000 between the three months ended March 31, 2016 and 2015. The net increase in noninterest expense between the comparative periods is primarily the result of increases in salaries and employee benefits, occupancy expense and professional fees.

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.

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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 March 31, 2016, 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 \$16,147,000, or 2.23% to a balance of \$741,791,000 at March 31, 2016, from the balance of \$725,644,000 at December 31, 2015, and increased \$63,367,000, or 9.34%, from the balance of \$678,424,000 at March 31, 2015. Total deposits of \$637,327,000 at March 31, 2016, increased \$15,522,000, or 2.50%, from the balance reported at December 31, 2015, and increased \$59,060,000, or 10.21%, from the balance of \$578,267,000 reported at March 31, 2015. Cash and cash equivalents decreased \$262,000, or 0.21%, between December 31, 2015 and March 31, 2016; net loans increased \$2,908,000, or 0.58%, to a balance of \$508,571,000; and investment securities increased \$13,501,000, or 43.70%, during the first quarter of 2016.

Earning assets averaged approximately \$645,089,000 during the three months ended March 31, 2016, as compared to \$593,316,000 for the same period in 2015. Average interest-bearing liabilities increased to \$374,161,000 for the three months ended March 31, 2016, from \$361,971,000 reported for the comparative period of 2015.

Loans and Leases

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 earning assets. Loans totaled \$517,678,000 at March 31, 2016, an increase of \$2,360,000, or 0.46%, when compared to the balance of \$515,318,000 at December 31, 2015, and an increase of \$25,433,000, or 5.17%, when compared to the balance of \$492,245,000 reported at March 31, 2015. Loans on average increased \$35,795,000, or 7.67%, between the three months ended March 31, 2015 and March 31, 2016, with loans averaging \$502,576,000 for the three months ended March 31, 2016, as compared to \$466,781,000 for the same period of 2015.

During the first quarter of 2016, increases were experienced in some loan categories. Real estate mortgage loans and commercial and industrial loans increased \$5,756,000, or 2.28%, and \$3,233,000, or 5.79%, respectively, during the first quarter of 2016. Agricultural loans decreased \$7,370,000, or 14.14%, and real estate construction and development loans decreased \$1,314,000, or 1.01%, during the same period.

The following table sets forth the amounts of loans outstanding by category at March 31, 2016 and December 31, 2015, the category percentages as of those dates, and the net change between the two periods presented.

Table 5. Loans

(in 000's)	March 31, 2016		December 31, 2015		Net Change	%
	Dollar Amount	% of Loans	Dollar Amount	% of Loans		
Commercial and industrial	\$59,059	11.4 %	\$55,826	10.8 %	\$3,233	5.79 %
Real estate – mortgage	257,988	49.8 %	252,232	48.9 %	5,756	2.28 %
RE construction & development	129,282	25.0 %	130,596	25.3 %	(1,314)	-1.01 %
Agricultural	44,767	8.6 %	52,137	10.1 %	(7,370)	-14.14 %

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Installment/other	26,582	5.2	%	24,527	4.9	%	2,055	8.38	%
Total Gross Loans	\$517,678	100.0%		\$515,318	100.0%		\$2,360	0.46	%

The overall average yield on the loan portfolio was 5.31% for the three months ended March 31, 2016, as compared to 5.46% for the three months ended March 31, 2015. At March 31, 2016, 44.4% of the Company's loan portfolio consisted of floating rate instruments, as compared to 43.2% of the portfolio at December 31, 2015, with the majority of those tied to the prime rate. Approximately 25.3% or \$58,245,000 of the floating rate loans had rate floors at March 31, 2016, making them effectively fixed-rate loans for certain increases in interest rates, and fixed-rate loans for all decreases in interest rates. Approximately \$661,000 of the \$58,245,000 in loans with floors have floor spreads of 100 basis points or more, meaning that interest rates would need to increase more than 1% (or 100 basis points) before the rates on those loans would increase and effectively

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become floating rate loans again. Of the \$58,245,000 in loans which comprise floating rate loans with floors, \$678,000 will mature in one year or less.

Deposits

Total deposits were \$637,327,000 at March 31, 2016, representing an increase of \$15,522,000, or 2.50% from the balance of \$621,805,000 reported at December 31, 2015, and an increase of \$59,060,000, or 10.21% from the balance of \$578,267,000 reported at March 31, 2015.

The following table sets forth the amounts of deposits outstanding by category at March 31, 2016 and December 31, 2015, and the net change between the two periods presented.

Table 6. Deposits

(in 000's)	March 31, 2016	December 31, 2015	Net Change	Percentage Change	
Noninterest bearing deposits	\$261,827	\$262,168	\$(341)	-0.13	%
Interest bearing deposits:					
NOW and money market accounts	235,946	226,886	9,060	3.99	%
Savings accounts	66,434	63,592	2,842	4.47	%
Time deposits:					
Under \$250,000	61,958	58,122	3,836	6.60	%
\$250,000 and over	11,162	11,037	125	1.13	%
Total interest bearing deposits	375,500	359,637	15,863	4.41	%
Total deposits	\$637,327	\$621,805	\$15,522	2.50	%

The Company's deposit base consists of two major components represented by noninterest bearing (demand) deposits and interest bearing deposits, totaling \$261,827,000 and \$375,500,000 at March 31, 2016, respectively. Interest bearing deposits consist of time certificates, NOW and money market accounts, and savings deposits. Total interest bearing deposits increased \$15,863,000, or 4.41%, between December 31, 2015 and March 31, 2016, and noninterest bearing deposits decreased \$341,000, or 0.13% between the same two periods presented. Included in the increase of \$15,863,000 in interest bearing deposits during the three months ended March 31, 2016, are increases of \$9,060,000 in NOW and money market accounts, \$2,842,000 in savings accounts, and \$3,961,000 in time deposits.

Core deposits, as defined by the Company as consisting of all deposits other than time deposits of more than \$250,000 and brokered deposits, continue to provide the foundation for the Company's principal sources of funding and liquidity. These core deposits amounted to 90.43% and 90.25% of the total deposit portfolio at March 31, 2016 and December 31, 2015, respectively. Brokered deposits totaled \$12,146,000 at March 31, 2016, as compared to \$8,546,000 at December 31, 2015, and \$13,009,000 at March 31, 2015. Brokered deposits were 1.91% and 1.37% of total deposits at March 31, 2016 and December 31, 2015, respectively.

On a year-to-date average, the Company experienced an increase of \$44,149,000, or 7.72%, in total deposits between the three months ended March 31, 2016 and March 31, 2015. Between these two periods, average interest bearing deposits increased \$14,001,000 or 3.98%, and total noninterest-bearing deposits increased \$30,148,000, or 13.72%, on a year-to-date average basis.

Short-Term Borrowings

At March 31, 2016, the Company had collateralized lines of credit with the Federal Reserve Bank of San Francisco totaling \$259,645,000, as well as Federal Home Loan Bank (FHLB) lines of credit totaling \$2,642,000. At March 31, 2016, the Company had uncollateralized lines of credit with both Pacific Coast Bankers Bank ("PCBB") and Zion's Bank, totaling \$10,000,000 and \$20,000,000, respectively. These lines of credit generally have interest rates tied to either the Federal Funds rate, short-term U.S. Treasury rates, or LIBOR. All lines of credit are on an "as available" basis and can be revoked by the grantor at any time. At March 31, 2016 and March 31, 2015, the Company had no outstanding borrowings. The Company had collateralized FRB lines of credit of \$302,456,000, collateralized FHLB lines of credit totaling \$2,854,000, an uncollateralized

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line of credit with PCBB of \$10,000,000, and an uncollateralized line of credit with Zions Bank of \$20,000,000 at December 31, 2015.

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 subjective and contingent upon 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 evaluated individually for specific impairment under the asset-specific component of the allowance.

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

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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 and categorized as pass, special mention, substandard, doubtful, or 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 downgrades. 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, doubtful, and loss which are not considered impaired. At March 31, 2016, impaired and classified loans totaled \$38,994,000, or 7.5%, of gross loans as compared to \$39,512,000 or 7.7% of gross loans at December 31, 2015.

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.

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 March 31, 2016 and December 31, 2015, as well as classified loans at those period-ends.

(in 000's)	March 31, 2016	December 31, 2015
Specific allowance – impaired loans	\$2,387	\$ 3,097
Formula allowance – classified loans not impaired	1,351	1,385
Formula allowance – special mention loans	56	75
Total allowance for special mention and classified loans	3,794	4,557
Formula allowance for pass loans	5,032	5,086
Unallocated allowance	892	70
Total allowance for loan losses	\$9,718	\$ 9,713
Impaired loans	23,287	23,612
Classified loans not considered impaired	15,707	15,900

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Total classified loans / impaired loans	\$38,994	\$ 39,512
Special mention loans not considered impaired	\$2,233	\$ 2,562

Impaired loans decreased \$325,000 between December 31, 2015 and March 31, 2016 and the specific allowance related to impaired loans decreased \$710,000 between December 31, 2015 and March 31, 2016. The formula allowance related to classified and special mention unimpaired loans decreased by \$53,000 between December 31, 2015 and March 31, 2016. The unallocated allowance increased from \$70,000 at December 31, 2015 to \$892,000 at March 31, 2016. The increase in unallocated allowance is the result of declining historical loss factors and a decrease in specific allowance on impaired loans.

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While economic conditions have improved and there has been a corresponding reduction in required loss reserves, the Company has a concentration in loans to finance CRE, construction and land development activities not secured by real estate. These loans have inherently higher risk characteristics and management believes maintaining additional, unallocated reserves to address the inherent losses in these loans that is not reflected in the Company's ALLL methodology is reasonable and appropriate. Further, the level of unallocated reserve is within the Company's policy limits. The level of "pass" loans increased approximately \$2,645,000 between December 31, 2015 and March 31, 2016. The related formula allowance decreased \$54,000 during the same period. The formula allowance for "pass loans" is derived from the loan loss factors under migration analysis.

The Company's methodology includes features that are intended to reduce the difference between estimated and actual 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, 2015, 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. The Company's Loan Committee meets weekly and 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.

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 March 31, 2016 and December 31, 2015, the Company's recorded investment in impaired loans totaled \$23,287,000 and \$23,679,000, respectively. Included in total impaired loans at March 31, 2016, are \$10,038,000 of impaired loans for which the related specific allowance was \$2,387,000, as well as \$13,249,000 of impaired loans that, as a result of write-downs or the

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sufficiency of the fair value of the collateral, did not have a specific allowance. Total impaired loans at December 31, 2015 included \$16,404,000 of impaired loans for which the related specific allowance was \$3,097,000 as well as \$7,275,000 in impaired loans that, as a result of write-downs or the sufficiency of the fair value of the collateral, did not have a specific allowance. The average recorded investment in impaired loans was \$23,483,000 during the first quarter of 2016. 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 has been performing for a prescribed period of time under the current contractual terms, income is recognized under the accrual method. At March 31, 2016, included in impaired loans, were troubled debt restructures totaling \$18,591,000. Nonaccrual loans, totaling \$7,964,000, were included in that balance. The remaining troubled debt restructures, totaling \$10,627,000, were current with regards to payments, and were performing according to their modified contractual terms.

The largest category of impaired loans at March 31, 2016 was real estate construction loans, comprising approximately 50.08% of total impaired loans. Real estate mortgage loans and commercial and industrial loans represented approximately 20.35% and 25.33%, respectively, of total impaired loan balances at March 31, 2016. Of the \$5,898,000 in commercial and industrial impaired loans reported at March 31, 2016, three loans, with recorded investments of \$743,000, were secured by real estate. 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 at March 31, 2016, approximately \$11,732,000, or 50.4%, are secured by real estate. The majority of impaired real estate construction and development loans are for the purpose of residential construction, residential and commercial acquisition and development, and land development. Residential construction loans are made for the purpose of building residential 1-4 single family homes. Residential and commercial acquisition and development loans are made for the purpose of purchasing land, developing that land if required, and developing real estate or commercial construction projects on those properties. Land development loans are made for the purpose of converting raw land into construction-ready building sites. The following table summarizes the components of impaired loans and their related specific reserves at March 31, 2016 and December 31, 2015.

	Impaired Loan Balance	Reserve	Impaired Loan Balance	Reserve
(in 000's)	March 31, 2016	March 31, 2016	December 31, 2015	December 31, 2015
Commercial and industrial	\$ 5,898	\$ 1,192	\$ 5,201	\$ 530
Real estate – mortgage	4,740	599	5,293	635
RE construction & development	11,661	596	12,519	1,282
Agricultural	11	—	16	—
Installment/other	977	—	650	650
Total Impaired Loans	\$ 23,287	\$ 2,387	\$ 23,679	\$ 3,097

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 maximize collection. The Company makes various types of concessions when structuring TDRs including rate reductions, payment extensions, and forbearance. At March 31, 2016, approximately \$4,237,000 of the total \$18,591,000 in TDRs was comprised of real estate mortgages. An additional \$11,632,000 was related to real estate construction and development loans.

Total troubled debt restructurings increased 0.45% at March 31, 2016 compared to December 31, 2015. Nonaccrual TDRs increased by 6.47% while accruing TDRs decreased by 3.64% over the same period. Within TDR categories, total residential mortgages and real estate construction TDRs showed a decrease of 6.34%. Many of these credits are related to real estate projects that slowed significantly or stalled during the recession, leading the Company to pursue

restructuring of the qualified credits allowing the real estate market time to recover and developers opportunity to finish projects at a slower pace. Concessions granted in these circumstances include lengthened maturities and/or rate reductions that enabled the borrower to finish the projects and may be entirely successful. In large part, current successes are related to a recovering real estate market.

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The following table summarizes TDRs by type, classified separately as nonaccrual or accrual, which are included in impaired loans at March 31, 2016 and December 31, 2015.

	Total TDRs	Nonaccrual TDRs	Accruing TDRs
(in 000's)	March 31, 2016	March 31, 2016	March 31, 2016
Commercial and industrial	\$ 1,735	\$ 955	\$ 780
Real estate - mortgage:			
Commercial real estate	1,557	1,224	333
Residential mortgages	2,680	—	2,680
Home equity loans	—	—	—
Total real estate mortgage	4,237	1,224	3,013
RE construction & development	11,632	4,808	6,824
Agricultural	10	—	10
Installment/other	977	977	—
Commercial lease financing	—	—	—
Total Troubled Debt Restructurings	\$ 18,591	\$ 7,964	\$ 10,627

	Total TDRs	Nonaccrual TDRs	Accruing TDRs
(in 000's)	December 31, 2015	December 31, 2015	December 31, 2015
Commercial and industrial	\$ 898	\$ 327	\$ 571
Real estate - mortgage:			
Commercial real estate	1,243	1,243	—
Residential mortgages	3,533	—	3,533
Home equity loans	—	—	—
Total real estate mortgage	4,776	1,243	3,533
RE construction & development	12,168	5,260	6,908
Agricultural	16	—	16
Installment/other	650	650	—
Commercial lease financing	—	—	—
Total Troubled Debt Restructurings	\$ 18,508	\$ 7,480	\$ 11,028

Of the \$18,591,000 in total TDRs at March 31, 2016, \$7,964,000 were on nonaccrual status at period-end. Of the \$18,508,000 in total TDRs at December 31, 2015, \$7,480,000 were on nonaccrual status at period-end. As of March 31, 2016, 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).

For a restructured loan to return to accrual status there needs to be at least 6 months successful payment history. In addition, the Company's Credit Administration performs a financial analysis of the credit to determine whether the borrower has the ability to continue to perform successfully over the remaining life of the loan. This includes, but is not limited to, a review of financial statements and a cash flow analysis of the borrower. Only after determining that the borrower has the ability to perform under the terms of the loans will the restructured credit be considered for accrual status.

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The following table summarizes special mention loans by type at March 31, 2016 and December 31, 2015.

(in thousands)	March 31, December 31,	
	2016	2015
Commercial and industrial	\$ 625	\$ 946
Real estate - mortgage:		
Commercial real estate	1,608	1,616
Residential mortgages	—	—
Home equity loans	—	—
Total real estate mortgage	1,608	1,616
RE construction & development	—	—
Agricultural	—	—
Installment/other	—	—
Commercial lease financing	—	—
Total Special Mention Loans	\$ 2,233	\$ 2,562

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 which creates pressure on loan pricing. Low interest rates and a weak 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 increased its level of troubled debt restructurings, when it 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. Local unemployment rates in the San Joaquin Valley have improved, but remain elevated compared with other regions and 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 possible credit losses, provisions made to that allowance, and charge-off and recovery activity affecting the allowance for the three months ended March 31, 2016 and March 31, 2015.

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Table 7. Allowance for Credit Losses - Summary of Activity

(in 000's)	March 31, 2016	March 31, 2015
Total loans outstanding at end of period before deducting allowances for credit losses	\$518,289	\$492,560
Average loans outstanding during period	502,576	466,781
Balance of allowance at beginning of period	9,713	10,771
Loans charged off:		
Real estate	(22)	—
Commercial and industrial	(3)	(215)
Installment and other	(7)	(3)
Total loans charged off	(32)	(218)
Recoveries of loans previously charged off:		
Real estate	38	37
Commercial and industrial	19	237
Installment and other	2	4
Total loan recoveries	59	278
Net loans recovered	27	60
Provision (recovery of provision) charged to operating expense	(22)	459
Balance of allowance for credit losses at end of period	\$9,718	\$11,290
Net loan recoveries to total average loans (annualized)	(0.02)%	(0.05)%
Net loan recoveries to loans at end of period (annualized)	(0.02)%	(0.05)%
Allowance for credit losses to total loans at end of period	1.88 %	2.29 %
Net loan recoveries to allowance for credit losses (annualized)	(1.11)%	(2.13)%
(Recovery of provision) provision for credit losses to net recoveries (annualized)	(325.93)%	3,060.00 %

Total loan charge-offs decreased \$187,000 during the three months ended March 31, 2016 when compared to the three months ended March 31, 2015. Loan recoveries totaled \$59,000 during the three months ended March 31, 2016, decreasing by \$219,000 from the same period in 2015.

At March 31, 2016 and March 31, 2015, \$322,000 and \$282,000, respectively, of the formula allowance is allocated to unfunded loan commitments and is, therefore, reported separately in other liabilities on the consolidated balance sheet. Management believes that the 1.88% credit loss allowance at March 31, 2016 is adequate to absorb known and inherent risks in the loan portfolio. No assurance can be given, however, regarding economic conditions or other circumstances which may adversely affect the Company's service areas and result in future losses to the loan portfolio.

It is the Company's policy to discontinue the accrual of interest income on loans when reasonable doubt exists with respect to the timely collectability of interest or principal due or the ability of the borrower to otherwise 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. Interest collected is thereafter credited to principal. Management may grant exceptions to this policy if the loans are well secured and in the process of collection.

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Table 8. Nonperforming Assets

(in 000's)	March 31, December		
	2016	31, 2015	
Nonaccrual Loans (1)	\$8,353	\$8,193	
Restructured Loans	10,627	11,028	
Total nonperforming loans	18,980	19,221	
Other real estate owned	12,207	12,873	
Total nonperforming assets	\$31,187	\$32,094	
Nonperforming loans to total gross loans	3.67	% 3.73	%
Nonperforming assets to total assets	4.20	% 4.42	%
Allowance for loan losses to nonperforming loans	51.20	% 50.53	%

(1) Included in nonaccrual loans at March 31, 2016 and December 31, 2015 are restructured loans totaling \$7,964,000 and \$7,480,000, respectively.

Non-performing loans decreased \$241,000 between December 31, 2015 and March 31, 2016. Nonaccrual loans increased \$160,000 between December 31, 2015 and March 31, 2016, with real estate mortgage and real estate construction loans comprising approximately 76.87% of total nonaccrual loans at March 31, 2016. The following table summarizes the nonaccrual totals by loan category for the periods shown. The ratio of the allowance for loan losses to nonperforming loans increased from 50.53% at December 31, 2015 to 51.20% at March 31, 2016.

(in 000's)	Balance		Change from
	March 31, 2016	December 31, 2015	
Nonaccrual Loans:			December 31, 2015
Commercial and industrial	\$ 955	\$ 328	\$ 627
Real estate - mortgage	1,613	1,635	(22)
RE construction & development	4,808	5,580	(772)
Installment/other	977	650	327
Total Nonaccrual Loans	\$ 8,353	\$ 8,193	\$ 160

Loans past due more than 30 days receive increased management attention and are monitored for increased risk. The Company continues to move past due loans to nonaccrual status in an ongoing effort to recognize and address loan problems as early and most effectively as possible. As impaired loans, nonaccrual and restructured loans are reviewed for specific reserve allocations, the allowance for credit losses is adjusted accordingly.

Except for the nonaccrual loans included in the above table, or those included in the impaired loan totals, there were no loans at March 31, 2016 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.

Asset/Liability Management – Liquidity and Cash Flow

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.

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Liquidity

Liquidity management may be described as the ability to maintain sufficient cash flows to fulfill 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.

The Company continues to emphasize liability management as part of its overall asset/liability strategy. Through the discretionary acquisition of short term borrowings, the Company has, when needed, been able to provide liquidity to fund asset growth while, at the same time, better utilizing its capital resources, and better controlling interest rate risk. This does not preclude the Company from selling assets such as investment securities to fund liquidity needs but, with favorable borrowing rates, the Company has maintained a positive yield spread between borrowed liabilities and the assets which those liabilities fund. If, at some time, rate spreads become unfavorable, the Company has the ability to utilize an asset management approach and, either control asset growth or fund further growth with maturities or sales of investment securities. At March 31, 2016, the Company had no borrowings, as its deposit base currently provides funding sufficient to support its asset values.

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, is maintained at a level deemed sufficient to provide the cash outlay necessary to fund loan growth as well as any customer deposit runoff that may occur. Additional liquidity requirements may be funded with overnight or term borrowing arrangements with various correspondent banks, FHLB and the Federal Reserve Bank. 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 March 31, 2016, the Bank had 69.87% of total assets in the loan portfolio and a loan to deposit ratio of 81.32%, as compared to 71.02% of total assets in the loan portfolio and a loan to deposit ratio of 82.88% at December 31, 2015. Liquid assets at March 31, 2016, include cash and cash equivalents totaling \$125,489,000 as compared to \$125,751,000 at December 31, 2015. Other sources of liquidity include collateralized lines of credit from the Federal Home Loan Bank, and from the Federal Reserve Bank totaling \$272,287,000 and an uncollateralized lines of credit from Pacific Coast Banker's Bank (PCBB) of \$10,000,000 and Zion's Bank of \$20,000,000 at March 31, 2016.

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 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 interest on the Company's junior subordinated debt and for the parent company's operating expenses. During the three months ended March 31, 2016, the Company received \$104,000 in cash dividends from the Bank.

Cash Flow

The period-end balances of cash and cash equivalents for the periods shown are as follows (from Consolidated Statements of Cash Flows – in 000's):

(in 000's)	Balance
December 31, 2014	\$103,577
March 31, 2015	\$85,478
December 31, 2015	\$125,751
March 31, 2016	\$125,489

Cash and cash equivalents decreased \$262,000 during the three months ended March 31, 2016, as compared to a decrease of \$18,099,000 during the three months ended March 31, 2015.

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The Company had a net cash outflow from operations of \$239,000 for the three months ended March 31, 2016 and a cash inflow from operations totaling \$2,064,000 for the period ended March 31, 2015. The Company experienced net cash outflows from investing activities totaling \$15,545,000 related to the purchase of investment securities and a purchase of a residential mortgage loan pool during the three months ended March 31, 2016. For the three months ended March 31, 2015, the Company experienced net cash outflows from investing activities of \$33,058,000 due to an increase in organic loan growth and a purchase of a residential mortgage pool.

During the three months ended March 31, 2016, the Company experienced net cash inflows from financing activities totaling \$15,522,000, primarily as the result of increases in demand deposits accounts. For the three months ended March 31, 2015, the Company experienced net cash inflows of \$12,895,000 from financing activities due to increases in demand deposit and savings accounts.

The Company has the ability to increase or decrease loan growth, increase or decrease deposits and borrowings, or a combination of both to manage balance sheet liquidity.

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 MOU requires 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

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regulatory approvals, since June 2014, the DBO and the Federal Reserve have been approving the Bank's payment of dividends to the Company to cover the Company's tax payments, operating expenses, 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 13.20% and 13.30% at March 31, 2016 and 2015, 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 March 31, 2016, 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:

Table 9. Capital Ratios

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	Ratio at March 31, 2016	Ratio at December 31, 2015	Minimum for Capital Adequacy	Minimum requirement for "Well Capitalized" Institution
Total capital to risk weighted assets				
Company	16.74%	16.65%	8.00%	N/A
Bank	16.80%	16.69%	8.00%	10.00%
Tier 1 capital to risk-weighted assets				
Company	15.49%	15.40%	6.00%	N/A
Bank	15.54%	15.43%	6.00%	8.00%
Common equity tier 1 capital to risk-weighted assets				
Company	14.26%	14.10%	4.50%	N/A
Bank	15.54%	15.43%	4.50%	6.50%
Tier 1 capital to adjusted average assets (leverage)				
Company	13.19%	12.95%	4.00%	N/A
Bank	13.20%	12.94%	4.00%	5.00%

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 (commonly referred to as "Basel III") as well as requirements encompassed by the Dodd-Frank Act.

The final rules set a new common equity tier 1 requirement and higher minimum tier 1 requirements for all banking organizations. They also place limits on capital distributions and certain discretionary bonus payments if a banking organization does not maintain a buffer of common equity tier 1 capital above minimum capital requirements. The rules revise the prompt corrective action framework to incorporate the new regulatory capital minimums. They also enhance risk sensitivity and address weaknesses identified over recent years with the measure of risk-weighted assets. As of March 31, 2016, the Company and the Bank meet 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 March 31, 2016, the Bank's cash dividends of \$104,000 paid to the Company were approved by the Federal Reserve and the DBO. These dividends partially funded the Company's operating costs and payments of interest on its junior subordinated

debentures

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

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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 is provided by a third-party vendor, and has been approved by the Federal Reserve Bank. At March 31, 2016, the bank was not subject to a reserve requirement.

Item 4. Controls and Procedures

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, our management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and our management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As of March 31, 2016, the end of the period covered by this report, an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures was carried out. Based on the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level.

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 quarter ended March 31, 2016, 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.

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PART II. Other Information

Item 1. Legal Proceedings

Not applicable

Item 1A. Risk Factors

There have been no material changes to the risk factors disclosed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2015.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None during the quarter ended March 31, 2016.

Item 3. Defaults Upon Senior Securities

Not applicable

Item 4. Mine Safety Disclosures

Not applicable

Item 5. Other Information

Not applicable

Item 6. Exhibits:

(a) Exhibits:

11 Computation of Earnings per Share*

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

* Data required by Accounting Standards Codification (ASC) 260, Earnings per Share, is provided in Note 8 to the consolidated financial statements in this report.

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Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

United Security Bancshares

Date: May 5, 2016 /S/ Dennis R. Woods

Dennis R. Woods
President and
Chief Executive Officer

/S/ Bhavneet Gill

Bhavneet Gill
Senior Vice President and Chief Financial Officer