

UNITED SECURITY BANCSHARES  
Form 10-Q  
May 16, 2011

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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, 2011.
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM                      TO                      .

Commission file number: 000-32987

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

CALIFORNIA (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

Aggregate market value of the Common Stock held by non-affiliates as of the last business day of the registrant's most

recently completed second fiscal quarter - June 30, 2010: \$32,434,746

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, 2011: 13,133,871

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## PART I. Financial Information

United Security Bancshares and Subsidiaries  
 Consolidated Balance Sheets – (unaudited)  
 March 31, 2011 and December 31, 2010

(in thousands except shares)	March 31, 2011	December 31, 2010
<b>Assets</b>		
Cash and due from banks	\$ 14,036	\$ 13,259
Cash and due from FRB	89,180	85,171
Cash and cash equivalents	103,216	98,430
Interest-bearing deposits in other banks	1,406	4,396
Investment securities available for sale (at fair value)	51,625	51,503
Loans and leases	432,824	441,691
Unearned fees	(560 )	(645 )
Allowance for credit losses	(16,745 )	(16,520 )
Net loans	415,519	424,526
Accrued interest receivable	2,099	2,152
Premises and equipment – net	12,738	12,909
Other real estate owned	35,151	35,580
Intangible assets	1,011	1,209
Goodwill	5,977	5,977
Cash surrender value of life insurance	15,625	15,493
Investment in limited partnership	1,745	1,851
Deferred income taxes - net	9,054	8,878
Other assets	14,971	15,306
<b>Total assets</b>	<b>\$ 670,137</b>	<b>\$ 678,210</b>
<b>Liabilities &amp; Shareholders' Equity</b>		
<b>Liabilities</b>		
<b>Deposits</b>		
Noninterest bearing	\$ 164,969	\$ 139,690
Interest bearing	390,689	417,776
<b>Total deposits</b>	<b>555,658</b>	<b>557,466</b>
Other borrowings	25,000	32,000
Accrued interest payable	171	222
Accounts payable and other liabilities	4,638	4,606
Junior subordinated debentures (at fair value)	11,074	10,646
<b>Total liabilities</b>	<b>596,541</b>	<b>604,940</b>
<b>Shareholders' Equity</b>		
Common stock, no par value 20,000,000 shares authorized, 13,133,871 and 13,000,840 issued and outstanding, in 2011 and 2010, respectively	40,301	39,869
Retained earnings	33,736	33,807
Accumulated other comprehensive loss	(441 )	(406 )
<b>Total shareholders' equity</b>	<b>73,596</b>	<b>73,270</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 670,137</b>	<b>\$ 678,210</b>

See notes to consolidated financial statements

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

(In thousands except shares and EPS)	Quarter Ended March 31,	
	2011	2010
<b>Interest Income:</b>		
Loans, including fees	\$6,420	\$7,540
Investment securities – AFS – taxable	597	853
Investment securities – AFS – nontaxable	-	15
Federal funds sold	-	8
Interest on deposits in FRB	51	2
Interest on deposits in other banks	10	10
<b>Total interest income</b>	<b>7,078</b>	<b>8,428</b>
<b>Interest Expense:</b>		
Interest on deposits	768	1,158
Interest on other borrowings	85	107
<b>Total interest expense</b>	<b>853</b>	<b>1,265</b>
<b>Net Interest Income Before Provision for Credit Losses</b>	<b>6,225</b>	<b>7,163</b>
<b>Provision for Credit Losses</b>	<b>890</b>	<b>1,631</b>
<b>Net Interest Income</b>	<b>5,335</b>	<b>5,532</b>
<b>Noninterest Income:</b>		
Customer service fees	867	948
Increase in cash surrender value of bank-owned life insurance	141	134
(Gain) loss on sale of other real estate owned	280	(56)
(Loss) gain on fair value of financial liability	(367)	157
Other	207	128
<b>Total noninterest income</b>	<b>1,128</b>	<b>1,311</b>
<b>Noninterest Expense:</b>		
Salaries and employee benefits	2,321	2,281
Occupancy expense	893	913
Data processing	24	19
Professional fees	439	387
FDIC/DFI insurance assessments	513	391
Director fees	58	57
Amortization of intangibles	162	203
Correspondent bank service charges	76	76
Impairment loss on core deposit intangible	36	57
Impairment loss on investment securities (cumulative total other-than-temporary loss of \$3.6 million, net of \$3.9 million recognized in other comprehensive loss, pre-tax)	0	244
Impairment loss on OREO	684	821
Loss on California tax credit partnership	106	106
OREO expense	232	282
Other	513	488
<b>Total noninterest expense</b>	<b>6,057</b>	<b>6,325</b>
<b>Income Before Taxes on Income</b>	<b>406</b>	<b>518</b>
<b>Provision for Taxes on Income</b>	<b>50</b>	<b>76</b>
<b>Net Income</b>	<b>\$356</b>	<b>\$442</b>
<b>Other comprehensive income, net of tax:</b>		

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Unrealized gain on available for sale securities, and past service costs of employee benefit plans – net of income tax (benefit) expense of \$(23), and \$378	(35	)	567
Comprehensive Income	\$321		\$1,009
Net Income per common share			
Basic	\$0.03		\$0.03
Diluted	\$0.03		\$0.03
Shares on which net income per common shares were based			
Basic	13,133,871		13,133,871
Diluted	13,133,871		13,133,871

See notes to consolidated financial statements

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

(In thousands except shares)	Common stock Number of Shares	Common stock Amount	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance January 1, 2010	12,496,499	\$37,575	\$40,499	\$ (2,253 )	\$75,821
Net changes in unrealized loss on available for sale securities (net of income tax expense of \$378)				567	567
Common stock dividends	124,953	655	(655 )		0
Stock-based compensation expense		5			5
Net Income			442		442
Balance March 31, 2010	12,621,452	38,235	40,286	(1,686 )	76,835
Net changes in unrealized loss on available for sale securities (net of income tax benefit of \$962)				1,443	1,443
Net changes in unrecognized past service Cost on employee benefit plans (net of income tax benefit of \$109)				(163 )	(163 )
Common stock dividends	382,388	1,598	(1,598 )		0
Stock-based compensation expense		36			36
Net Income			(4,881 )		(4,881 )
Balance December 31, 2010	13,003,840	39,869	33,807	(406 )	73,270
Net changes in unrealized loss on available for sale securities (net of income tax benefit of \$24)				(36 )	(36 )
Net changes in unrecognized past service Cost on employee benefit plans (net of income tax expense of \$1)				1	1
Common stock dividends	130,031	427	(427 )		0
Stock-based compensation expense		5			5
Net Income			356		356
Balance March 31, 2011	13,133,871	\$40,301	\$33,736	\$ (441 )	\$73,596

See notes to consolidated financial statements



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Consolidated Statements of Cash Flows (unaudited)

(In thousands)	Three Months Ended	
	2011	March 31, 2010
Cash Flows From Operating Activities:		
Net income	\$ 356	\$ 442
Adjustments to reconcile net income: to cash provided by operating activities:		
Provision for credit losses	890	1,631
Depreciation and amortization	460	539
Accretion of investment securities	(16 )	(10 )
Decrease in accrued interest receivable	53	67
Decrease in accrued interest payable	(51 )	(96 )
(Decrease) increase in unearned fees	(86 )	182
Increase in income taxes payable	25	8
Stock-based compensation expense	5	5
Decrease (increase) in accounts payable and accrued liabilities	46	(58 )
(Gain) loss on sale of other real estate owned	(280 )	56
Impairment loss on other real estate owned	684	821
Impairment loss on core deposit intangible	36	57
Impairment loss on investment securities	0	244
Increase in surrender value of life insurance	(132 )	(126 )
Loss (gain) on fair value option of financial liabilities	367	(157 )
Loss on tax credit limited partnership interest	106	106
Net decrease in other assets	55	513
Net cash provided by operating activities	2,518	4,224
Cash Flows From Investing Activities:		
Net decrease (increase) in interest-bearing deposits with banks	2,990	(657 )
Redemption of correspondent bank stock	147	0
Purchases of available-for-sale securities	(4,486 )	(1,001 )
Maturities and calls of available-for-sale securities	4,360	4,269
Net decrease (increase) in loans	7,074	(18,196 )
Net proceeds from settlement of other real estate owned	1,118	2,143
Capital expenditures for premises and equipment	(126 )	(141 )
Net cash provided by (used in) investing activities	11,077	(13,583 )
Cash Flows From Financing Activities:		
Net increase in demand deposits and savings accounts	17,319	4,781
Net (decrease) increase in certificates of deposit	(19,128 )	16,041
Net decrease in federal funds purchased	0	0
Decrease in other borrowings	(7,000 )	(3,000 )
Proceeds from note payable	0	75
Net cash (used in) provided by financing activities	(8,809 )	17,897
Net increase in cash and cash equivalents	4,786	8,538
Cash and cash equivalents at beginning of period	98,430	29,229

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Cash and cash equivalents at end of period	\$103,216	\$37,767
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See notes to consolidated financial statements

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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 2010 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.

Certain reclassifications have been made to the 2010 financial statements to conform to the classifications used in 2011.

New Accounting Standards:

In July 2010, the FASB issued Accounting Standards Update No. 2010-20 Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses (“ASU 2010-20”). ASU 2010-20 expanded disclosures related to allowance for credit losses and the credit quality of financing receivables. The update requires the allowance and other credit quality disclosures to be provided on a disaggregated basis. The Company adopted the period-end disclosure provisions of this update as of December 31, 2010. Accordingly, the Company adopted the activity-based disclosure provisions of this amendment during the first quarter 2011.

In April 2011, the FASB issued ASU No. 2011-02, Receivables (Topic 310): A Creditor’s Determination of Whether a Restructuring Is a Troubled Debt Restructuring. ASU 2011-02 clarifies the guidance in ASC 310-40 Receivables: Troubled Debt Restructurings by Creditors. Creditors are required to identify a restructuring as a troubled debt restructuring if the restructuring constitutes a concession and the debtor is experiencing financial difficulties. ASU 2011-02 clarifies guidance on whether a creditor has granted a concession and clarifies the guidance on a creditor’s evaluation of whether a debtor is experiencing financial difficulties. In addition, ASU 2011-02 also precludes the creditor from using the effective interest rate test in the debtor’s guidance on restructuring of payables when evaluating whether a restructuring constitutes a troubled debt restructuring. The effective date of ASU 2011-2 for public entities is effective for the first interim or annual period beginning on or after June 15, 2011, and should be applied retrospectively to the beginning of the annual period of adoption. If, as a result of adoption, an entity identifies newly impaired receivables, an entity should apply the amendments for purposes of measuring impairment prospectively for the first interim or annual period beginning on or after June 15, 2011. The Company intends to adopt the methodologies prescribed by this ASU by the date required and is currently evaluating the impact of adopting this ASU.

2. Investment Securities Available for Sale and Other Investments

Following is a comparison of the amortized cost and fair value of securities available-for-sale, as of March 31, 2011 and December 31, 2010:

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(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value (Carrying Amount)
<b>March 31, 2011:</b>				
U.S. Government agencies	\$ 33,549	\$ 1,277	\$ (3 )	\$ 34,823
U.S. Government agency CMO's	6,418	501	(2 )	6,917
Residential mortgage obligations	11,818	0	(1,933 )	9,885
	\$ 51,785	\$ 1,778	\$ (1,938 )	\$ 51,625
<b>December 31, 2010:</b>				
U.S. Government agencies	\$ 32,486	\$ 1,303	\$ (1 )	\$ 33,788
U.S. Government agency CMO's	7,203	552	0	7,755
Residential mortgage obligations	11,955	0	(1,995 )	9,960
	\$ 51,644	\$ 1,855	\$ (1,996 )	\$ 51,503

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The amortized cost and fair value of securities available for sale at March 31, 2011, 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.

(In thousands)	March 31, 2011	
	Amortized Cost	Fair Value (Carrying Amount)
Due in one year or less	\$6,519	\$6,538
Due after one year through five years	9,935	10,016
Due after five years through ten years	2,711	2,859
Due after ten years	14,384	15,410
Collateralized mortgage obligations	18,236	16,802
	\$51,785	\$51,625

There were no realized gains or realized losses on sales of available-for-sale securities during the three months ended March 31, 2011 or 2010. There were no other-than-temporary impairment losses on certain of the Company's residential mortgage obligations (private label collateralized mortgage obligations) for the three months ended March 31, 2011. There were other-than-temporary impairment losses on certain of the Company's residential mortgage obligations (private label collateralized mortgage obligations) totaling \$244,000 for the three months ended March 31, 2010.

Securities that have been impaired less than 12 months at March 31, 2011 are comprised of two U.S. government agency securities with a weighted average life of 0.4 years and one collateralized mortgage obligation with a weighted average life of 0.3 years. As of March 31, 2011, there were three residential mortgage obligations with a total weighted average life of 6.3 years that have been impaired for twelve months or more.

The following summarizes the total of impaired investment securities at March 31, 2011 (see discussion below for other than temporarily impaired securities included here):

(In thousands)	Less than 12 Months		12 Months or More		Total	
	Fair Value (Carrying Amount)	Unrealized Losses	Fair Value (Carrying Amount)	Unrealized Losses	Fair Value (Carrying Amount)	Unrealized Losses
Securities available for sale:						
U.S. Government agencies	\$2,131	\$(3 )	\$0	\$0	\$2,131	\$(3 )
U.S. Government agency CMO's	438	(2 )	0	0	438	(2 )
Residential mortgage Obligations	0	0	9,885	(1,933 )	9,885	(1,933 )
Total impaired securities	\$2,569	\$(5 )	\$9,885	\$(1,933 )	\$12,454	\$(1,938 )

Securities that have been impaired less than 12 months at March 31, 2010 are comprised of one U.S. government agency security with a weighted average life of 3.0 years and one collateralized mortgage obligation with a weighted average life of 0.8 years. As of March 31, 2010, there were three residential mortgage obligations and one other investment security with a total weighted average life of 3.2 years that have been impaired for twelve months or more.



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The following summarizes impaired investment securities at March 31, 2010:

(In thousands)	Less than 12 Months		12 Months or More		Total	
	Fair Value (Carrying Amount)	Unrealized Losses	Fair Value (Carrying Amount)	Unrealized Losses	Fair Value (Carrying Amount)	Unrealized Losses
Securities available for sale:						
U.S. Government agencies	\$ 990	\$ (12 )	\$ 0	\$ 0	\$ 990	\$ (12 )
U.S. Government agency CMO's	1,323	(12 )	0	0	1,323	(12 )
Residential mortgage obligations	0	0	9,893	(3,674 )	9,893	(3,674 )
Obligations of state and political subdivisions	0	0	0	0	0	0
Other investment securities	0	0	7,518	(482 )	7,518	(482 )
Total impaired securities	\$ 2,313	\$ (24 )	\$ 17,411	\$ (4,156 )	\$ 19,724	\$ (4,180 )

At March 31, 2011 and December 31, 2010, available-for-sale securities with an amortized cost of approximately \$47.0 million and \$46.7 million (fair value of \$47.5 million and \$47.2 million) were pledged as collateral for FHLB borrowings, public funds, and treasury tax and loan balances.

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 entity 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 non-agency collateralized mortgage obligations. Under this model, the Company compares the present value of the remaining cash flows as estimated at the preceding evaluation date to the current expected remaining cash flows. An OTTI is deemed to have occurred if there has been an adverse change in the remaining expected future cash flows.

Other-than-temporary-impairment occurs under the new guidance 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 an entity 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 difference between the investment's amortized cost basis and its fair value at the balance sheet date. If an entity does not intend to sell the security and it is not more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis 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, 2011, the decline in market value for all but three (see below) of the impaired securities 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 it will be required to sell the securities before their anticipated recovery, the Company does not consider these securities to be other-than-temporarily impaired at March 31, 2011.



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At March 31, 2011, the Company had three non-agency collateralized mortgage obligations which have been impaired more than twelve months. The three non-agency collateralized mortgage obligations had an aggregate fair value of \$9.9 million and unrealized losses of approximately \$1.9 million at March 31, 2011. All three non-agency mortgage-backed securities were rated less than high credit quality at March 31, 2011. The Company evaluated these three non-agency collateralized mortgage obligations for OTTI by comparing the present value of expected cash flows to previous estimates to determine whether there had been adverse changes in cash flows during the period. The OTTI evaluation was conducted utilizing the services of a third party specialist and consultant in MBS and CMO products. The cash flow assumptions used in the evaluation at March 31, 2011 utilized a discounted cash flow valuation technique using a "Liquidation Scenario" whereby loans are evaluated by delinquency and are assigned probability of default and loss factors deemed appropriate in the current economic environment. The liquidation scenarios assume that all loans 60 or more days past due are liquidated and losses are realized over a period of between six and twenty four months based upon current 3-month trailing loss severities obtained from financial data sources. As a result of the impairment evaluation, the Company determined that there had been adverse changes in cash flows in all three of the three non-agency collateralized mortgage obligations, and concluded that these three non-agency collateralized mortgage obligations were other-than-temporarily impaired. At March 31, 2011, the three CMO securities had cumulative other-than-temporary-impairment losses of \$3.6 million, \$1.7 million of which was recorded in other comprehensive loss. During the three months ended March 31, 2011, the company recorded no OTTI impairment expense on the three CMO securities. During the three months ended March 31, 2010, the company recorded OTTI impairment expense of \$244,000 on the three CMO securities. These three non-agency collateralized mortgage obligations remained classified as available for sale at March 31, 2011.

The following table details the three non-agency collateralized mortgage obligations with other-than-temporary-impairment, their credit rating at March 31, 2011, the related credit losses recognized in earnings during the quarter, and impairment losses in other comprehensive loss:

	RALI 2006-QS1G A10 Rated D	RALI 2006 QS8 A1 Rated D	CWALT 2007-8CB A9 Rated CCC	Total
Amortized cost – before OTTI	\$ 4,489	\$ 1,342	\$ 7,618	\$ 13,449
Credit loss – Quarter ended March 31, 2011	(1,020 )	(288 )	(323 )	(1,631 )
Other impairment (OCI)	(503 )	(161 )	(1,269 )	(1,933 )
Carrying amount – March 31, 2011	\$ 2,966	\$ 893	\$ 6,026	\$ 9,885
Total impairment - March 31, 2011	\$ (1,523 )	\$ (449 )	\$ (1,592 )	\$ (3,564 )

The total other comprehensive loss (OCI) balance of \$1.9 million in the above table is included in unrealized losses of 12 months or more at March 31, 2011.

The following table summarizes amounts related to credit losses recognized in earnings for the quarters ended March 31, 2011 and 2010.

(in thousands)	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010
Beginning balance - credit losses	\$ 1,795	\$ 843
Additions:		
Initial credit impairments	0	0

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Subsequent credit impairments	0	244
Reductions:		
For securities sold or credit losses realized on principal payments	(164 )	0
Due to change in intent or requirement to sell	0	0
For increase expected in cash flows	0	0
Ending balance - credit losses	\$1,631	\$1,087

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## 3. Loans and Leases

Loans are comprised of the following:

(In thousands)	March 31, 2011	December 31, 2010
Commercial and business loans	\$157,890	\$ 154,624
Government program loans	4,028	4,600
Total commercial and industrial	\$161,918	\$ 159,224
Real estate – mortgage:		
Commercial real estate	131,095	131,632
Residential mortgages	23,679	23,764
Home Improvement and Home Equity loans	2,290	2,385
Total real estate mortgage	157,064	157,781
RE construction and development	64,730	65,182
Agricultural	36,278	46,308
Installment	12,672	12,891
Lease financing	162	305
Total Loans	\$432,824	\$ 441,691

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

Commercial and industrial loans represent 37.4% of total loans at March 31, 2011 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 36.3% of total loans at March 31, 2011, are secured by trust deeds on primarily commercial property, but are also secured by trust deeds on single family residences. Repayment of real estate mortgage loans is generally from the cash flow of the borrower.

Commercial real estate mortgage loans comprise the largest segment of this loan category and are available on all types of income producing and commercial properties, including: office buildings, shopping centers; apartments and motels; owner occupied buildings; manufacturing facilities and more. Commercial real estate mortgage loans can also be used to refinance existing debt. Although real estate associated with the business is the primary collateral for commercial real estate mortgage loans, the underlying real estate is not the source of repayment. Commercial real estate loans are made under the premise that the loan will be repaid from the borrower's business operations, rental income associated with the real property, or personal assets.

Residential mortgage loans are provided to individuals to finance or refinance single-family residences. Residential mortgages are not a primary business line offered by the Company, and are generally of a shorter term than conventional mortgages, with maturities ranging from three to fifteen years on average.

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

Real estate construction and development loans, representing 15.0% of total loans at March 31, 2011, consist of loans for residential and commercial construction projects, as well as land acquisition and development, or land held for future development. Loans in this category are secured by real estate including improved and unimproved land, as well as single-family residential, multi-family residential, and commercial properties in various stages of completion. All real estate loans have established equity requirements. Repayment on construction loans is generally from long-term mortgages with other lending institutions obtained at completion of the project.

Agricultural loans represent 8.4% of total loans at March 31, 2011 and are generally secured by land, equipment, inventory and receivables. Repayment is from the cash flow of the borrower.

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Lease financing loans, representing less than 0.1% of total loans at March 31, 2011, consist of loans to small businesses, which are secured by commercial equipment. Repayment of the lease obligation is from the cash flow of the borrower.

In the normal course of business, the Company is party to financial instruments with off-balance sheet risk to meet the financing needs of its customers. At March 31, 2011 and December 31, 2010, these financial instruments include commitments to extend credit of \$63.1 million and \$67.8 million, respectively, and standby letters of credit of \$1.9 million and \$1.8 million, respectively. These instruments involve elements of credit risk in excess of the amount recognized on the balance sheet. The contract amounts of these instruments reflect the extent of the involvement the Company has in off-balance sheet financial instruments.

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

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

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

Occasionally, shared appreciation agreements are made between the Company and the borrower on certain construction loans where the Company agrees to receive interest on the loan at maturity rather than monthly and the borrower agrees to share in the profits of the project. Due to the difficulty in calculating future values, shared appreciation income is recognized when received. The Company does not participate in a significant number of shared appreciation projects. The Company received no shared appreciation income during the three months ended March 31, 2011 or 2010.

**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, 2011:

March 31, 2011 (000's)	Loans 30-60 Days Past Due	Loans 61-89 Days Past Due	Loans	Total Past Due Loans	Current Loans	Total Loans	Accruing
			90 or More Days Past Due				Loans 90 or More Days Past Due
Commercial and Business Loans	\$7,286	\$0	\$11,575	\$18,861	\$139,029	\$157,890	\$521
Government Program Loans	157	83	335	575	3,453	4,028	59
	7,443	83	11,910	19,436	142,482	161,918	580

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Total Commercial and Industrial							
Commercial Real Estate Term Loans							
	2,644	1,093	0	3,737	127,358	131,095	0
Single Family Residential Loans							
	1,194	0	424	1,618	22,061	23,679	328
Home Improvement and Home Equity Loans							
	147	37	18	202	2,088	2,290	0
Total Real Estate Mortgage							
	3,985	1,130	442	5,557	151,507	157,064	328
Total RE Construction and Development Loans							
	905	0	3,934	4,839	59,891	64,730	0
Total Agricultural Loans							
	0	0	560	560	35,718	36,278	450
Consumer Loans							
	67	85	41	193	12,227	12,420	0
Overdraft protection Lines							
	0	0	0	0	80	80	0
Overdrafts							
	0	0	0	0	172		