AMERICAN RIVER BANKSHARES
Form 10-Q
November 07, 2013

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended or	September 30, 2013

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

For the transition period from	to

Commission File Number: 0-31525

AMERICAN RIVER BANKSHARES
(Exact name of registrant as specified in its charter)

California	68-0352144
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

3100 Zinfandel Drive, Suite 450, Rancho Cordova, California	95670
(Address of principal executive offices)	(Zip Code)

(916) 851-0123

(Registrant's telephone number, including area code)

Not Applicable
(Former name, former address and former fiscal year, if changed since last report.)

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 requirements for the past 90 days.

Yes x   No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes x   No o

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

Large accelerated filer o	Accelerated filer o
Non-accelerated filer x (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes x   No o

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

No par value Common Stock – 8,755,021 shares outstanding at November 7, 2013.

AMERICAN RIVER BANKSHARES

INDEX TO QUARTERLY REPORT ON FORM 10-Q
FOR THE QUARTER ENDED SEPTEMBER 30, 2013

PART I-FINANCIAL INFORMATION

Item 1. Financial Statements.

AMERICAN RIVER BANKSHARES

CONSOLIDATED BALANCE SHEET

(Unaudited)

(dollars in thousands)	September 30, 2013	December 31, 2012
ASSETS		
Cash and due from banks	$ 35,152	$ 55,461
Interest-bearing deposits in banks	1,000	750
Investment securities:		
Available-for-sale, at fair value	268,614	231,839
Held-to-maturity, at amortized cost	1,303	2,117
Loans and leases, less allowance for loan and lease losses of $5,567 at September 30, 2013 and $5,781 at December 31, 2012	249,730	252,118
Premises and equipment, net	1,581	1,888
Federal Home Loan Bank stock	3,248	3,254
Goodwill and other intangible assets	16,321	16,321
Other real estate owned	5,624	12,237
Bank owned life insurance	12,618	12,858
Accrued interest receivable and other assets	7,050	7,546
	$ 602,241	$ 596,389
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Noninterest bearing	$ 144,673	$ 151,201
Interest-bearing	345,911	327,055
Total deposits	490,584	478,256
Short-term borrowings	8,000	2,000
Long-term borrowings	8,000	16,000
Accrued interest payable and other liabilities	5,886	6,139
Total liabilities	512,470	502,395
Commitments and contingencies		
Shareholders' equity:		

Preferred stock, no par value; 20,000,000 shares authorized; none outstanding		
Common stock, no par value; 20,000,000 shares authorized; issued and outstanding – 8,833,562 shares at September 30, 2013 and 9,327,203 shares at December 31, 2012	64,168	67,977
Retained earnings	23,899	21,732
Accumulated other comprehensive income, net of taxes	1,704	4,285
Total shareholders' equity	89,771	93,994
	$ 602,241	$ 596,389

See Notes to Unaudited Consolidated Financial Statements

AMERICAN RIVER BANKSHARES
CONSOLIDATED STATEMENT OF INCOME
(Unaudited)

(dollars in thousands, except per share data)

For the periods ended September 30,	Three months		Nine months	
	2013	2012	2013	2012
Interest income:				
Interest and fees on loans	$3,541	$4,101	$10,699	$12,655
Interest on deposits in banks	1	2	2	8
Interest and dividends on investment securities:				
Taxable	1,004	1,007	2,597	2,828
Exempt from Federal income taxes	210	224	652	673
Dividends	1	—	9	4
Total interest income	4,757	5,334	13,959	16,168
Interest expense:				
Interest on deposits	286	395	918	1,248
Interest on borrowings	75	75	225	206
Total interest expense	361	470	1,143	1,454
Net interest income	4,396	4,864	12,816	14,714
Provision for loan and lease losses	—	410	200	1,365
Net interest income after provision for loan and lease losses	4,396	4,454	12,616	13,349
Noninterest income:				
Service charges on deposit accounts	140	173	438	563
Gain on sale of securities	16	1	19	76
Income from other real estate owned properties	79	261	242	653
Other noninterest income	227	277	836	807
Total noninterest income	462	712	1,535	2,099
Noninterest expense:				
Salaries and employee benefits	2,020	2,104	6,413	6,339
Occupancy	301	299	897	893
Furniture and equipment	194	214	579	606
Federal Deposit Insurance Corporation assessments	109	140	220	422
Expenses related to other real estate owned	137	573	637	1,415
Other expense	775	889	2,404	2,707
Total noninterest expense	3,536	4,219	11,150	12,382
Income before provision for income taxes	1,322	947	3,001	3,066
Provision for income taxes	429	167	834	729
Net income	$893	$780	$2,167	$2,337

Basic earnings per share	$0.10	$0.08	$0.24	$0.24
Diluted earnings per share	$0.10	$0.08	$0.24	$0.24
Cash dividends per share	$0.00	$0.00	$0.00	$0.00

See Notes to Unaudited Consolidated Financial Statements

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AMERICAN RIVER BANKSHARES
CONSOLIDATED STATEMENT OF COMPRENENSIVE INCOME (LOSS)
(Unaudited)

(dollars in thousands, except per share data)

For the periods ended September 30,	Three months		Nine months	
	2013	2012	2013	2012
Net income	$893	$780	$2,167	$2,337
Other comprehensive income (loss):				
Unrealized holding gains (losses) on investment securities arising during the period	666	1,132	(4,283)	2,543
Deferred tax (expense) benefit	(266)	(453)	1,713	(1,018)
Unrealized holding gains (losses) on investment securities arising during the period, net of tax	400	679	(2,570)	1,525
Reclassification adjustment for realized gains included in net income	(16)	(1)	(19)	(76)
Tax effect	6	—	8	30
Realized gains, net of tax	(10)	(1)	(11)	(46)
Total other comprehensive income (loss)	390	678	(2,581)	1,479
Comprehensive income (loss)	$1,283	$1,458	$(414)	$3,816

See Notes to Unaudited Consolidated Financial Statements

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AMERICAN RIVER BANKSHARES
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
(Unaudited)

(dollars in thousands)	Common Stock		Retained	Accumulated Other Comprehensive	Total Shareholders'
	Shares	Amount	Earnings	Income	Equity
Balance, January 1, 2012	9,890,909	72,016	18,525	3,558	94,099
Net income			3,207		3,207
Other comprehensive income, net of tax:					
Net change in unrealized gains on available-for-sale investment securities				727	727
Net restricted stock awarded and related compensation expense	11,683	110			110
Stock option compensation expense		45			45
Retirement of common stock	(575,389)	(4,194)			(4,194)
Balance, December 31, 2012	9,327,203	67,977	21,732	4,285	93,994
Net income			2,167		2,167
Other comprehensive loss, net of tax:					
Net change in unrealized gains on available-for-sale investment securities				(2,581)	(2,581)
Net restricted stock award activity and related compensation expense	11,448	80			80
Stock option compensation expense		17			17
Retirement of common stock	(505,089)	(3,906)			(3,906)
Balance, September 30, 2013	8,833,562	$64,168	$23,899	$ 1,704	$ 89,771

See Notes to Unaudited Consolidated Financial Statements

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AMERICAN RIVER BANKSHARES
CONSOLIDATED STATEMENT OF CASH FLOWS
(Unaudited)

(dollars in thousands)
For the nine months ended September 30,

	2013	2012
Cash flows from operating activities:		
Net income	$2,167	$2,337
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan and lease losses	200	1,365
Increase (decrease) in deferred loan origination fees, net	11	(89)
Depreciation and amortization	397	606
Gain on sale and call of investment securities	(19)	(76)
Amortization of investment security premiums and discounts, net	4,386	3,143
Gain on life insurance death benefit	(118)	—
Increase in cash surrender values of life insurance policies	(61)	(199)
Stock based compensation expense	97	125
Loss on sale and write-down of other real estate owned	102	1,224
Decrease in accrued interest receivable and other assets	2,216	524
Decrease in accrued interest payable and other liabilities	(253)	(147)
Net cash provided by operating activities	9,125	8,813
Cash flows from investing activities:		
Proceeds from the sale of available-for-sale investment securities	6,159	8,500
Proceeds from matured available-for-sale investment securities	875	825
Proceeds from called available-for-sale investment securities	590	195
Purchases of available-for-sale investment securities	(99,420)	(67,485)
Proceeds from principal repayments for available- for-sale investment securities	46,350	38,165
Proceeds from principal repayments for held-to-maturity investment securities	816	1,274
Net (increase) decrease in interest-bearing deposits in banks	(250)	250
Net decrease in loans	1,573	14,173
Proceeds from sale of other real estate	7,303	1,371
Capitalized additions to other real estate	(187)	—
Death benefit from life insurance policy	419	—
Net decrease (increase) in FHLB stock	6	(161)
Purchases of equipment	(90)	(283)
Net cash used in investing activities	(35,856)	(3,176)

AMERICAN RIVER BANKSHARES
CONSOLIDATED STATEMENT OF CASH FLOWS (Continued)
(Unaudited)

(dollars in thousands)
For the nine months ended September 30,

	2013	2012
Cash flows from financing activities:		
Net increase in demand, interest-bearing and savings deposits	$15,850	$2,680
Net (decrease) increase in time deposits	(3,522)	1,760
Net increase (decrease) in short-term borrowings	6,000	(3,000)
Net (decrease) increase in long-term borrowings	(8,000)	2,000
Cash paid to repurchase common stock	(3,906)	(4,194)
Net cash provided by (used in) financing activities	$6,422	$(754)
(Decrease) increase in cash and cash equivalents	(20,309)	4,883
Cash and cash equivalents at beginning of year	55,461	23,768
Cash and cash equivalents at end of period	$35,152	$28,651

See Notes to Unaudited Consolidated Financial Statements

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AMERICAN RIVER BANKSHARES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2013

1. CONSOLIDATED FINANCIAL STATEMENTS

In the opinion of management, the unaudited consolidated financial statements contain all adjustments (consisting of only normal recurring adjustments) necessary to present fairly the consolidated financial position of American River Bankshares (the "Company") at September 30, 2013 and December 31, 2012, the results of its operations and statement of comprehensive income for the three-and nine-month periods ended September 30, 2013 and 2012, its cash flows for the nine-month periods ended September 30, 2013 and 2012 and its statement of changes in shareholders' equity for the year ended December 31, 2012 and the nine months ended September 30, 2013 in conformity with accounting principles generally accepted in the United States of America.

Certain disclosures normally presented in the notes to the annual consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted. The Company believes that the disclosures are adequate to make the information not misleading. These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's 2012 annual report on Form 10-K. The results of operations for the three-month and nine-month periods ended September 30, 2013 may not necessarily be indicative of the operating results for the full year.

In preparing such financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenues and expenses for the period. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to significant changes in the near term relate to the determination of the allowance for loan and lease losses, the provision for taxes, the valuation of goodwill and the estimated fair value of investment securities, impaired loans and other real estate owned.

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

2. STOCK-BASED COMPENSATION

Equity Plans

On March 17, 2010, the Board of Directors adopted the 2010 Equity Incentive Plan (the “2010 Plan”). The 2010 Plan was approved by the Company’s shareholders on May 20, 2010. In 2000, the Board of Directors adopted and the Company’s shareholders approved a stock option plan (the “2000 Plan”), under which 260,594 options remain outstanding at September 30, 2013. At September 30, 2013, there were 17,329 stock options and 23,990 restricted shares outstanding and the total number of authorized shares that remain available for issuance under the 2010 Plan was 1,435,581. The 2010 Plan provides for the following types of stock-based awards: incentive stock options; nonqualified stock options; stock appreciation rights; restricted stock; restricted performance stock; unrestricted Company stock; and performance units. Awards granted under the 2000 Plan were either incentive stock options or nonqualified stock options. Under the 2010 Plan, the awards may be granted to employees and directors under incentive and nonstatutory agreements and other awards agreements. The 2010 Plan and the 2000 Plan (collectively the “Plans”) require that the option price may not be less than the fair market value of the stock at the date the option is granted. The option awards under the Plans expire on dates determined by the Board of Directors, but not later than ten years from the date of award. The vesting period is generally five years; however, the vesting period can be modified at the discretion of the Company’s Board of Directors. Outstanding option awards under the Plans are exercisable until their expiration, however, no new options will be awarded under the 2000 Plan. New shares are issued upon exercise of an option.

The grant date fair value of awards is determined by the market price of the Company's common stock on the date of grant and is recognized ratably as compensation expense or director expense over the vesting periods. The shares of common stock granted pursuant to such agreements vest in increments over one to five years from the date of grant. The shares awarded to employees and directors under the restricted stock agreements vest on the applicable vesting dates only to the extent the recipient of the shares is then an employee or a director of the Company or one of its subsidiaries, and each recipient will forfeit all of the shares that have not vested on the date his or her employment or service is terminated.

Equity Compensation

For the three-month periods ended September 30, 2013 and 2012, the compensation cost recognized for equity compensation was $28,000 and $46,000, respectively. The recognized tax benefit for equity compensation expense was $13,000 and $17,000, for the three-month periods ended September 30, 2013 and 2012, respectively. For the nine-month periods ended September 30, 2013 and 2012, the compensation cost recognized for equity compensation was $97,000 and $125,000, respectively. The recognized tax benefit for equity compensation expense was $35,000 and $43,000, for the nine-month periods ended September 30, 2013 and 2012, respectively.

At September 30, 2013, the total compensation cost related to nonvested stock option awards not yet recorded is $36,000. This amount will be recognized over the next 3.8 years and the weighted average period of recognizing these costs is expected to be 1.3 years. At September 30, 2013, the total compensation cost related to restricted stock awards not yet recorded is $163,000. This amount will be recognized over the next 3.8 years and the weighted average period of recognizing these costs is expected to be 1.2 years.

Equity Plans Activity

Stock Options

There were no stock options awarded during the three- and nine-month periods ended September 30, 2013. There were 17,329 stock options awarded during the three- and nine-month periods ended September 30, 2012 at an average exercise price of $7.07. The weighted average grant date fair value of options granted for the three- and nine-month periods ended September 30, 2012 was $2.31. A summary of option activity under the Plans as of September 30, 2013 and changes during the period then ended is presented below:

Options	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value ($000)
Outstanding at January 1, 2013	305,670	$ 16.71	4.0 years	$ —
Granted	—	—	—	—
Exercised	—	—	—	—
Cancelled	27,747	11.71	—	—
Outstanding at September 30, 2013	277,923	$ 17.21	3.4 years	$ 43
Vested at September 30, 2013	255,372	$ 18.06	3.0 years	$ 16
Non-vested at September 30, 2013	22,551	$ 7.63	7.4 years	$ 27

Restricted Stock

There were no shares of restricted stock awarded during the three-month period ended September 30, 2013 and 11,448 shares of restricted stock awarded during the nine-month period ended September 30, 2013. The 11,448 restricted common shares will vest one year from the date of the award. There were no shares of restricted stock awarded during the three-month period ended September 30, 2012 and 16,207 shares of restricted stock awarded during the nine-month period ended September 30, 2012. Of the 16,207 restricted common shares, 9,898 will vest one year from the date of the award and 6,309 will vest over five years at 20% per year from the date of the award. Grant date fair value is determined by the market price of the Company's common stock on the date of grant ($7.86 on May 16, 2013 and $7.07 on May 16, 2012).

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There were 3,269 restricted awards that were fully vested during the three-month period ended September 30, 2013 and 14,427 restricted awards that were fully vested during the nine-month period ended September 30, 2013. There were 16,729 restricted awards that were fully vested during the three-and nine-month periods ended September 30, 2012. There were zero awards that had been forfeited during the three-and nine-month periods ended September 30, 2013. There were 1,278 awards that had been forfeited during the three-month period ended September 30, 2012 and 4,524 awards forfeited during the nine-month period ended September 30, 2012. The intrinsic value of nonvested restricted stock at September 30, 2013 was $211,000.

Restricted Stock	Shares	Weighted Average Grant Date Fair Value
Nonvested at January 1, 2013	26,969	$ 6.79
Awarded	11,448	7.86
Less: Vested	14,427	6.94
Less: Cancelled	—	—
Nonvested at September 30, 2013	23,988	$ 7.22

Other Equity Awards

There were no stock appreciation rights; restricted performance stock; unrestricted Company stock; or performance units awarded during the three-or nine-month periods ended September 30, 2013 or 2012.

The intrinsic value used for stock options and restricted stock was derived from the market price of the Company's common stock of $8.80 as of September 30, 2013.

3. COMMITMENTS AND CONTINGENCIES

In the normal course of business there are outstanding various commitments to extend credit which are not reflected in the financial statements, including loan commitments of approximately $22,565,000 and standby letters of credit of approximately $6,431,000 at September 30, 2013 and loan commitments of approximately $26,518,000 and standby letters of credit of approximately $6,506,000 at December 31, 2012. Such commitments relate primarily to real estate construction loans, revolving lines of credit and other commercial loans. However, all such commitments will not necessarily culminate in actual extensions of credit by the Company during 2013 as some of these are expected to expire without being fully drawn upon.

Standby letters of credit are commitments issued to guarantee the performance or financial obligation of a client to a third party. These guarantees are issued primarily relating to purchases of inventory, insurance programs, performance obligations to government agencies, or as security for real estate rents by commercial clients and are typically short-term in nature. Credit risk is similar to that involved in extending loan commitments to clients and accordingly, evaluation and collateral requirements similar to those for loan commitments are used. The majority of all such commitments are collateralized. The fair value of the liability related to these standby letters of credit, which represents the fees received for issuing the guarantees, was not significant at September 30, 2013 or December 31, 2012.

4. EARNINGS PER SHARE COMPUTATION

Basic earnings per share is computed by dividing net income by the weighted average common shares outstanding for the period (8,808,585 and 8,969,088 shares for the three-month and nine-month periods ended September 30, 2013, and 9,292,639 and 9,544,014 for the three-month and nine-month periods ended September 30, 2012). Diluted earnings per share reflect the potential dilution that could occur if securities or other contracts to issue common stock, such as stock options or restricted stock, result in the issuance of common stock. Diluted earnings per share is computed by dividing net income by the weighted average common shares outstanding for the period plus the dilutive effect of stock based awards. There were 8,702 and 5,715, respectively, dilutive shares for the three-month and nine-month periods ended September 30, 2013 and 4,866 and 9,468, respectively, dilutive shares for the three-month and nine-month periods ended September 30, 2012. There were 217,247 and 277,923, respectively, stock options that were excluded from the calculation as they were considered antidilutive for the three-month and nine-month periods ended September 30, 2013 and 320,195 and 322,085, respectively, antidilutive shares for the three-month and nine-month periods ended September 30, 2012. Earnings per share is retroactively adjusted for stock dividends and stock splits, if applicable, for all periods presented.

5. INVESTMENT SECURITIES

The amortized cost and estimated fair values of investment securities at September 30, 2013 and December 31, 2012 consisted of the following (dollars in thousands):

Available-for-Sale

	September 30, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
Mortgage-backed securities	$237,808	$ 3,794	$ (1,790)	$239,812
Obligations of states and political subdivisions	26,396	874	(156)	27,114
Corporate bonds	1,506	75	—	1,581
Equity securities:				
Corporate stock	64	43	—	107
	$265,774	$ 4,786	$ (1,946)	$268,614

	December 31, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
Mortgage-backed securities	$195,444	$ 5,661	$ (590)	$200,515
Obligations of states and political subdivisions	27,682	1,974	—	29,656
Corporate bonds	1,507	87	—	1,594

Equity securities:				
Corporate stock	64	10	—	74
	$224,697	$ 7,732	$ (590)	$231,839

Net unrealized gains on available-for-sale investment securities totaling $1,704,000 were recorded, net of $1,136,000 in tax liabilities, as accumulated other comprehensive income within shareholders' equity at September 30, 2013. Proceeds and gross realized gains from the sale and call of available-for-sale investment securities for the three-month period ended September 30, 2013 totaled $927,000 and $16,000, respectively, and for the nine-month period ended September 30, 2013 totaled $6,749,000 and $19,000, respectively. There were no transfers of available-for-sale investment securities for the three- and nine-month periods ended September 30, 2013.

Net unrealized gains on available-for-sale investment securities totaling $4,285,000 were recorded, net of $2,857,000 in tax liabilities, as accumulated other comprehensive income within shareholders' equity at December 31, 2012. Proceeds and gross realized gains from the sale and call of available-for-sale investment securities for the three-month period ended September 30, 2012 totaled $2,957,000 and $1,000, respectively, and for the nine-month period ended September 30, 2012 totaled $8,695,000 and $76,000, respectively. There were no transfers of available-for-sale investment securities for the three- and nine-month periods ended September 30, 2012.

Held-to-Maturity

September 30, 2013	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
Mortgage-backed securities	$ 1,303	$ 84	$ —	$ 1,387

December 31, 2012	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
Mortgage-backed securities	$ 2,117	$ 138	$ —	$ 2,255

There were no sales or transfers of held-to-maturity investment securities for the periods ended September 30, 2013 and September 30, 2012. Investment securities with unrealized losses at September 30, 2013 and December 31, 2012 are summarized and classified according to the duration of the loss period as follows (dollars in thousands):

	2013					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Available-for-Sale						
Debt securities:						
Mortgage-backed securities	$91,863	$ (1,766)	$2,177	$ (24)	$94,040	$ (1,790)
Obligations of states and political subdivisions	4,257	(156)	—	—	4,257	(156)
	$96,120	$ (1,922)	$2,177	$ (24)	$98,297	$ (1,946)

	2012					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Available-for-Sale						
Debt securities:						
Mortgage-backed securities	$37,440	$ (590)	—	—	$37,440	$ (590)
	$37,440	$ (590)	$ —	$ —	$27,440	$ (590)

There were no held-to-maturity investment securities with unrealized losses as of September 30, 2013 or December 31, 2012.

At September 30, 2013, the Company held 219 securities of which 45 were in a loss position for less than twelve months and one was in a loss position for twelve months or more. Of the 46 securities in a loss position, 41 are mortgage-backed securities and five are obligations of states and political subdivisions. At December 31, 2012, the Company held 196 securities of which 16 were in a loss position for less than twelve months and none were in a loss position for twelve months or more. All 16 securities in a loss position were mortgage-backed securities.

The unrealized loss on the Company's investments in mortgage-backed securities and obligations of states and political subdivisions is primarily driven by interest rates. Because the decline in market value is attributable to a change in interest rates and not credit quality, and because the Company has the ability and intent to hold these investments until recovery of fair value, which may be until maturity, management does not consider these investments to be other-than-temporarily impaired.

The amortized cost and estimated fair values of investment securities at September 30, 2013 by contractual maturity are shown below (dollars in thousands).

	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Within one year	$135	$136		
After one year through five years	4,889	5,075		
After five years through ten years	10,818	11,266		
After ten years	12,060	12,218		
	27,902	28,695		
Investment securities not due at a single maturity date:				
Mortgage-backed securities	237,808	239,812	$1,303	$ 1,387
Corporate stock	64	107	—	—
	$265,774	$268,614	$1,303	$ 1,387

Expected maturities will differ from contractual maturities because the issuers of the securities may have the right to call or prepay obligations with or without call or prepayment penalties.

6. IMPAIRED AND NONPERFORMING LOANS AND LEASES AND OTHER REAL ESTATE OWNED

At September 30, 2013 and December 31, 2012, the recorded investment in nonperforming loans and leases was approximately $4,847,000 and $5,474,000, respectively. Nonperforming loans and leases include all such loans and leases that are either placed on nonaccrual status or are 90 days past due as to principal or interest but still accrue interest because such loans are well-secured and in the process of collection. The Company considers a loan to be impaired when, based on current information and events, it is probable that it will be unable to collect all amounts due (principal and interest) according to the contractual terms of the original loan agreement. At September 30, 2013, the recorded investment in loans and leases that were considered to be impaired totaled $28,672,000, which includes $4,775,000 in nonaccrual loans and leases and $23,897,000 in performing loans and leases. Of the total impaired loans of $28,672,000, loans totaling $12,530,000 were deemed to require no specific reserve and loans totaling $16,142,000 were deemed to require a related valuation allowance of $1,837,000. At December 31, 2012, the recorded investment in loans and leases that were considered to be impaired totaled $26,553,000 and had a related valuation allowance of $1,595,000. If interest had been accruing on the nonperforming loans, such income would have approximated $101,000 and $129,000 for the three months ended September 30, 2013 and 2012, respectively, and approximated $269,000 and $601,000 for the nine months ended September 30, 2013 and 2012, respectively.

At September 30, 2013 and December 31, 2012, the recorded investment in other real estate owned (“OREO”) was $5,624,000 and $12,237,000, respectively. For the three months ended March 31, 2013, the Company sold six properties with balances of $3,743,000 for a loss of $93,000 and added a single property to OREO with a net book value totaling $432,000. The single property is improved land with a long-term lease for a self-storage facility in Sonoma County. For the three months ended June 30, 2013, the Company sold one property with a balance of $805,000 for a gain of $22,000 and did not add any new OREO property. For the three months ended September 30, 2013 the Company sold six properties with balances of $2,526,000 for a gain of $115,000 and added a single property with a net book value of $173,000. The property added is a single family residence in Calaveras County.

The Company periodically obtains property valuations to determine whether the recorded book value is considered fair value. During the first quarter of 2013, this valuation process did not result in any adjustments. During the second quarter of 2013, this valuation process resulted in the Company reducing the book value of four properties by $137,000 all of which was charged to OREO expense. During the third quarter of 2013, this valuation process resulted in the Company reducing the book value of a single property by $10,000 through a charge to OREO expense.

The September 30, 2013 OREO balance of $5,624,000 consists of nine properties including two commercial real estate properties in the total amount of $2,589,000, four commercial land properties in the total amount of $1,715,000, two residential land properties in the amount of $1,147,000 and one residential real estate property in the amount of $173,000.

Nonperforming loans and leases and OREO at September 30, 2013 and December 31, 2012 are summarized as follows:

(dollars in thousands)	September 30, 2013	December 31, 2012
Nonaccrual loans and leases that are current to terms (less than 30 days past due)	$ 1,167	$ 1,514
Nonaccrual loans and leases that are past due	3,680	3,960
Loans and leases past due 90 days and accruing interest	—	—
Other real estate owned	5,624	12,237
Total nonperforming assets	$ 10,474	$ 17,111
Nonperforming loans and leases to total loans and leases	1.90 %	2.12 %
Total nonperforming assets to total assets	1.74 %	2.97 %

Impaired loans and leases as of and for the periods ended September 30, 2013 and December 31, 2012 are summarized as follows:

(dollars in thousands)	As of September 30, 2013			As of December 31, 2012		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:						
Commercial	$628	$628	$ —	$1,248	$1,407	$ —
Real estate-commercial	11,613	11,810	—	10,882	11,603	—
Real estate-construction	252	252	—	263	263	—
Consumer	37	37	—	37	109	—
Subtotal	$12,530	$12,727	$ —	$12,430	$13,382	$ —
With an allowance recorded:						
Commercial	$1,515	$1,515	$ 579	$1,580	$1,580	$ 480
Real estate-commercial	9,501	9,818	877	8,223	8,287	786
Real estate-multi-family	1,658	1,751	115	1,681	1,774	122
Real estate-residential	3,336	3,336	239	2,429	2,483	179
Consumer	132	132	27	210	210	28
Subtotal	$16,142	$16,552	$ 1,837	$14,123	$14,334	$ 1,595
Total:						
Commercial	$2,143	$2,143	$ 579	$2,828	$2,987	$ 480
Real estate-commercial	21,114	21,628	877	19,105	19,890	786
Real estate-multi-family	1,658	1,751	115	1,681	1,774	122

Real estate-construction	252	252	—	263	263	—
Real estate-residential	3,336	3,336	239	2,429	2,483	179
Consumer	169	169	27	247	319	28
	$28,672	$29,279	$ 1,837	$26,553	$27,716	$ 1,595

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The following table presents the average balance related to impaired loans and leases for the periods indicated (dollars in thousands):

	Average Recorded Investments for the three months ended		Average Recorded Investments for the nine months ended	
	September 30, 2013	September 30, 2012	September 30, 2013	September 30, 2012
Commercial	$ 2,302	$ 3,193	$ 2,265	$ 2,703
Real estate-commercial	16,782	15,872	19,417	15,846
Real estate-multi-family	1,671	1,356	1,669	1,484
Real estate-construction	130	925	—	1,356
Real estate-residential	2,683	1,475	2,966	1,407
Leases	—	—	—	—
Agriculture	—	494	—	493
Consumer	175	408	174	604
Total	$ 23,743	$ 23,723	$ 26,491	$ 23,893

The following table presents the interest income recognized on impaired loans and leases for the periods indicated (dollars in thousands):

	Interest Income Recognized for the three months ended		Interest Income Recognized for the nine months ended	
	September 30, 2013	September 30, 2012	September 30, 2013	September 30, 2012
Commercial	$ 16	$ (15)	$ 48	$ 59
Real estate-commercial	393	86	686	416
Real estate-multi-family	19	14	58	44
Real estate-construction	3	—	10	—
Real estate-residential	56	(4)	108	41
Consumer	1	7	3	15
Total	$ 488	$ 88	$ 913	$ 575

7. TROUBLED DEBT RESTRUCTURINGS

At September 30, 2013, there were 24 loans and leases that were considered to be troubled debt restructurings. Of these loans and leases, 13 were modified and are currently performing (less than ninety days past due) totaling $4,938,000 and 11 are considered nonperforming (and included in the $4,847,000 discussed in Note 6), totaling $3,052,000. Of the 11 TDRs considered nonperforming, six are current to the modified terms. At September 30, 2013 and December 31, 2012, there were no unfunded commitments on those loans considered troubled debt restructures. See also “Impaired Loans and Leases” in “Item 2 - Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

The Company has allocated $980,000 and $1,575,000 of specific reserves to loans whose terms have been modified as troubled debt restructurings as of September 30, 2013 and December 31, 2012.

During the nine-month period ended September 30, 2013, the terms of six loans were modified as a troubled debt restructuring. The modifications of the terms of these loans were extensions of the maturity date and/or a reduction of the interest rate below the original loan rate.

The following table presents loans by class modified as troubled debt restructurings during the three months ended September 30, 2013 (dollars in thousands):

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled debt restructurings:			
Real estate – commercial	2	$ 348	$ 348
Total	2	$ 348	$ 348

The following table presents loans by class modified as troubled debt restructurings during the nine months ended September 30, 2013 (dollars in thousands):

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled debt restructurings:			
SFR (non owner-occupied)	1	$ 566	$ 566
Real estate – commercial	5	1,003	$ 984
Total	6	$ 1,569	$ 1,550

The troubled debt restructurings described above increased the allowance for loan and lease losses by $92,000 and resulted in $40,000 in charge offs during the nine months ended September 30, 2013.

The following table presents loans by class modified as troubled debt restructurings during the three months ended September 30, 2012 (dollars in thousands):

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment

Troubled debt restructurings:			
Commercial	2	$ 618	$ 618
Real estate – commercial	3	1,167	1,129
Real estate – multi-family	2	19	19
Total	7	$ 1,804	$ 1,766

The following table presents loans by class modified as troubled debt restructurings during the nine months ended September 30, 2012 (dollars in thousands):

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled debt restructurings:			
Commercial	7	$ 1,311	$ 1,311
Real estate – commercial	9	4,676	4,638
Real estate – multi-family	2	539	539
Real estate – residential	3	921	808
Other – agriculture	1	410	410
Other – consumer	4	50	50
Total	26	$ 7,907	$ 7,756

The troubled debt restructurings described above increased the allowance for loan and lease losses by $146,000 and resulted in charge offs of $38,000 during the three months ended September 30, 2012 and increased the allowance for loan and lease losses by $329,000 and resulted in charge offs of $151,000 during the nine months ended September 30, 2012.

The following table presents loans by class modified as troubled debt restructurings for which there was a payment default within twelve months following the modification during the period indicated (dollars in thousands):

Nine months ended September 30, 2013	Number of Loans	Recorded Investment
Troubled debt restructurings that subsequently defaulted:		
Commercial	1	$ 513
Total	1	$ 513

There were no payment defaults on troubled debt restructurings within 12 months following the modification for the three months ended September 30, 2013.

The following table presents loans by class modified as troubled debt restructurings for which there was a payment default within 12 months following the modification during the period indicated (dollars in thousands):

Nine months ended September 30, 2012	Number of Loans	Recorded Investment
Troubled debt restructurings that subsequently defaulted:		
Real estate – commercial	1	$ 506
Consumer	1	5
Total	2	$ 511

There were no payment defaults on troubled debt restructurings within 12 months following the modification for the three months ended September 30, 2012.

8. ALLOWANCE FOR LOAN AND LEASE LOSSES

The Company's loan and lease portfolio allocated by management's internal risk ratings as of September 30, 2013 and December 31, 2012 are summarized below:

September 30, 2013 (dollars in thousands)	Credit Risk Profile by Internally Assigned Grade				
		Real Estate			
	Commercial	Commercial	Multi-family	Construction	Residential
Grade:					
Pass	$21,154	$ 142,943	$ 9,751	$ 3,837	$ 13,025
Watch	1,282	10,989	1,163	3,428	3,427
Special mention	530	16,264	425	591	1,287
Substandard	1,401	12,344	508	—	611
Doubtful	239	—	—	—	—
Total	$24,606	$ 182,540	$ 11,847	$ 7,856	$ 18,350

	Credit Risk Profile by Internally Assigned Grade			
	Other Credit Exposure			
	Leases	Agriculture	Consumer	Total
Grade:				
Pass	$ 1,040	$ 2,729	$ 5,907	$ 200,386
Watch	—	—	23	20,312
Special mention		394	121	19,612
Substandard	—	—	125	14,989
Doubtful	—	—	—	239
Total	$ 1,040	$ 3,123	$ 6,176	$ 255,538

December 31, 2012 (dollars in thousands)	Credit Risk Profile by Internally Assigned Grade				
		Real Estate			
	Commercial	Commercial	Multi-family	Construction	Residential
Grade:					
Pass	$25,670	$ 134,969	$ 7,018	$ 3,049	$ 13,283
Watch	1,994	14,613	1,181	3,262	2,518
Special mention	653	16,041	441	607	1,163
Substandard	1,804	14,503	515	—	737
Doubtful	690	—	—	—	—
Total	$30,811	$ 180,126	$ 9,155	$ 6,918	$ 17,701

	Credit Risk Profile by Internally Assigned Grade			
	Other Credit Exposure			
	Leases	Agriculture	Consumer	Total
Grade:				
Pass	$ 1,506	$ 2,938	$ 7,696	$ 196,129
Watch	—	—	251	23,819

Special mention	—	402	153	19,460
Substandard	3	—	469	18,031
Doubtful	—	—	—	690
Total	$ 1,509	$ 3,340	$ 8,569	$ 258,129

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The allocation of the Company's allowance for loan and lease losses and by portfolio segment and by impairment methodology are summarized below:

September 30, 2013 (dollars in thousands)		Real Estate				Other				
	Commercial	Commercial	Multi-Family	Construction	Residential	Leases	Agriculture	Consumer	Unallocated	Total
Allowance for Loan and Lease Losses										
Beginning balance, January 1, 2013	$1,351	$2,526	$238	$594	$477	$3	$87	$262	$243	$5,781
Provision for loan losses	(247)	586	16	(70)	104	(1)	(11)	(94)	(83)	200
Loans charged off	(39)	(476)	—	—	(58)	—	—	(5)	—	(578)
Recoveries	100	23	—	—	41	—	—	—	—	164
Ending balance, September 30, 2013	$1,165	$2,659	$254	$524	$564	$2	$76	$163	$160	$5,567
Ending balance: Individually evaluated for impairment	$579	$877	$115	$—	$239	$—	$—	$27	$—	$1,837
Ending balance: Collectively evaluated for impairment	$586	$1,782	$139	$524	$325	$2	$76	$136	$160	$3,730
Loans										
Ending balance	$24,606	$182,540	$11,847	$7,856	$18,350	$1,040	$3,123	$6,176	$—	$255,538
Ending balance: Individually evaluated for impairment	$2,143	$21,114	$1,658	$252	$3,336	$—	$—	$169	$—	$28,672
Ending balance: Collectively evaluated for impairment	$22,463	$161,426	$10,189	$7,604	$15,014	$1,040	$3,123	$6,007	$—	$226,866
Allowance for Loan and Lease Losses										
Beginning balance, June 30, 2013	$1,279	$2,584	$247	$422	$554	$3	$91	$170	$330	$5,680
Provision for loan losses	(89)	184	7	102	(11)	(1)	(15)	(7)	(170)	—

Loans charged off	(28)	(121)	—	—	(20)	—	—	—	—	(169)
Recoveries	3	12	—	—	41	—	—	—	—	56
Ending balance, September 30, 2013	$1,165	$2,659	$254	$524	$564	$2	$76	$163	$160	$5,567

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December 31, 2012 (dollars in thousands)		Real Estate				Other				
	Commercial	Commercial	Multi-Family	Construction	Residential	Leases	Agriculture	Consumer	Unalloc	To
Ending balance: Individually evaluated for impairment	$480	$786	$122	$—	$179	$—	$—	$28	$—	$1
Ending balance: Collectively evaluated for impairment	$871	$1,740	$116	$594	$298	$3	$87	$234	$243	$4
<u>Loans</u>										
Ending balance	$30,811	$180,126	$9,155	$6,918	$17,701	$1,509	$3,340	$8,569	$—	$2
Ending balance: Individually evaluated for impairment	$2,828	$19,105	$1,681	$263	$2,429	$—	$—	$247	$—	$2
Ending balance: Collectively evaluated for impairment	$27,983	$161,021	$7,474	$6,655	$15,272	$ 1,509	$3,340	$8,322	$—	$

September 30, 2012 (dollars in thousands)		Real Estate				Other				
	Commercial	Commercial	Multi-Family	Construction	Residential	Leases	Agriculture	Consumer	Unallocated	Total
<u>Allowance for Loan and Lease Losses</u>										
Beginning balance, January 1, 2012	$1,536	$3,156	$198	$582	$609	$79	$167	$348	$366	$7,041
Provision for loan losses	(395)	728	122	228	36	(74)	257	463	—	1,365
Loans charged-off	(302)	(1,124)	(8)	(377)	(167)	(9)	(202)	(494)		(2,683)
Recoveries	15	136								