UNITED SECURITY BANCSHARES
Form 10-Q
August 06, 2018
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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2018
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM TO .

Commission file number: 000-32897

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

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

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 o No x

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing for the past 90 days. Yes x No o

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

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o

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

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 July 31, 2018: 16,901,618

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PART I. Financial Information

United Security Bancshares and Subsidiaries
Consolidated Balance Sheets – (unaudited)
June 30, 2018 and December 31, 2017

(in thousands except shares)	June 30, 2018	December 31, 2017
Assets		
Cash and non-interest bearing deposits in other banks	$29,939	$ 35,237
Due from Federal Reserve Bank ("FRB")	161,189	72,697
Cash and cash equivalents	191,128	107,934
Investment securities (at fair value)		
Available for sale ("AFS") securities	56,724	41,985
Marketable equity securities	3,659	3,737
Total investment securities	60,383	45,722
Loans	573,996	601,351
Unearned fees and unamortized loan origination costs, net	355	1,039
Allowance for credit losses	(8,425)	(9,267)
Net loans	565,926	593,123
Accrued interest receivable	8,392	6,526
Premises and equipment – net	10,041	10,165
Other real estate owned	5,745	5,745
Goodwill	4,488	4,488
Cash surrender value of life insurance	19,803	19,752
Investment in limited partnerships	1,592	1,601
Deferred tax assets - net	2,616	2,389
Other assets	9,354	8,391
Total assets	$879,468	$ 805,836
Liabilities & Shareholders' Equity		
Liabilities		
Deposits		
Noninterest bearing	$281,686	$ 307,299
Interest bearing	475,277	380,394
Total deposits	756,963	687,693
Accrued interest payable	43	44
Accounts payable and other liabilities	7,121	7,017
Junior subordinated debentures (at fair value)	10,125	9,730
Total liabilities	774,252	704,484
Shareholders' Equity		
Common stock, no par value 20,000,000 shares authorized, 16,901,618 issued and outstanding at June 30, 2018, and 16,885,615 at December 31, 2017	58,309	57,880
Retained earnings	46,025	44,182
Accumulated other comprehensive income (loss)	882	(710)
Total shareholders' equity	105,216	101,352
Total liabilities and shareholders' equity	$879,468	$ 805,836

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

	Quarter Ended June 30,		Six Months Ended June 30,	
(In thousands except shares and EPS)	2018	2017	2018	2017
Interest Income:				
Loans, including fees	$7,491	$ 7,579	$15,717	$ 14,804
Investment securities – AFS – taxable	265	229	457	453
Interest on deposits in FRB	681	301	1,065	484
Interest on deposits in other banks	—	1	—	2
Total interest income	8,437	8,110	17,239	15,743
Interest Expense:				
Interest on deposits	550	364	937	700
Interest on other borrowings	109	74	199	143
Total interest expense	659	438	1,136	843
Net Interest Income	7,778	7,672	16,103	14,900
Recovery of Provision for Credit Losses	(1,136)	(52)	(1,325)	(31)
Net Interest Income after Recovery of Provision for Credit Losses	8,914	7,724	17,428	14,931
Noninterest Income:				
Customer service fees	1,020	997	1,971	1,938
Increase in cash surrender value of bank-owned life insurance	132	134	257	266
Loss on marketable equity securities	(18)	—	(78)	—
Gain on proceeds from bank-owned life insurance	—	—	171	—
Loss on fair value of financial liability	(192)	(264)	(661)	(601)
Gain on sale of assets	29	—	29	—
Other	198	199	403	372
Total noninterest income	1,169	1,066	2,092	1,975
Noninterest Expense:				
Salaries and employee benefits	3,010	2,586	5,971	5,571
Occupancy expense	1,117	1,043	2,135	2,058
Data processing	38	25	90	52
Professional fees	392	345	727	600
Regulatory assessments	78	133	161	269
Director fees	81	75	162	143
Correspondent bank service charges	17	19	34	37
Loss on California tax credit partnership	5	10	9	119
Net cost (gain) on operation and sale of OREO	49	(309)	100	(277)
Other	531	680	929	1,226
Total noninterest expense	5,318	4,607	10,318	9,798
Income Before Provision for Taxes	4,765	4,183	9,202	7,108
Provision for Taxes on Income	1,373	1,691	2,653	2,845
Net Income	$3,392	$ 2,492	$6,549	$ 4,263

Net Income per common share				
Basic	$0.20	$ 0.15	$0.39	$ 0.25
Diluted	$0.20	$ 0.15	$0.39	$ 0.25
Shares on which net income per common shares were based				
Basic	16,899,968	16,875,336	16,895,135	16,792,083
Diluted	16,957,282	16,894,373	16,935,911	16,808,733

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

(In thousands)	Three Months Ended June 30, 2018	Three Months Ended June 30, 2017	Six Months Ended June 30, 2018	Six Months Ended June 30, 2017
Net Income	$3,392	$2,492	$6,549	$4,263
Unrealized holdings (loss) gain on securities	(171)	267	(428)	355
Unrealized gains on unrecognized post-retirement costs	18	13	27	26
Unrealized (loss) gain on TRUPs	(272)	—	295	—
Other comprehensive income (loss), before tax	(425)	280	(106)	381
Tax benefit (expense) related to securities	46	(107)	128	(142)
Tax expense related to unrecognized post-retirement costs	(5)	(6)	(8)	(11)
Tax benefit (expense) related to TRUPs	80	—	(88)	—
Total other comprehensive income (loss)	(304)	167	(74)	228
Comprehensive Income	$3,088	$2,659	$6,475	$4,491

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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 (Loss) Gain	Total
Balance December 31, 2016 (1)	16,705,594	$56,557	$40,701	$ (604)	$96,654
(1) Excludes 12,015 unvested restricted shares					
Other comprehensive income				228	228
Common stock dividends	167,082	1,221	(1,221)		—
Dividends on common stock ($0.05 per share)			(845)		(845)
Dividends payable ($0.05 per share)			(845)		(845)
Stock options exercised	2,514	6			6
Stock-based compensation expense		60			60
Net income			4,263		4,263
Balance June 30, 2017 (2)	16,875,190	$57,844	$42,053	$ (376)	$99,521
(2) Excludes 9,011 unvested restricted shares					
Other comprehensive loss				(221)	(221)
Reclassification of income tax effects from accumulated other comprehensive income			113	(113)	—
Dividends on common stock ($0.07 per share)			(1,180)		(1,180)
Dividends payable ($0.07 per share)			(1,182)		(1,182)
Restricted stock units released	10,425				—
Stock-based compensation expense		36			36
Net income			4,378		4,378
Balance December 31, 2017 (3)	16,885,615	$57,880	$44,182	$ (710)	$101,352
(3) Excludes 46,511 unvested restricted shares					
Other comprehensive loss				(74)	(74)
Adoption of ASU 2016-01: reclassification of TRUPS to accumulated other comprehensive income			(1,482)	1,482	—
Adoption of ASU 2016-01: recognition of previously unrealized losses within marketable equity securities			(184)	184	—
Dividends on common stock ($0.09 per share)			(1,520)		(1,520)
Dividends payable ($0.09 per share)			(1,520)		(1,520)
Restricted stock units released	16,003				—
Stock-based compensation expense		429			429
Net income			6,549		6,549
Balance June 30, 2018 (4)	16,901,618	$58,309	$46,025	$ 882	$105,216
(4) Excludes 78,508 unvested restricted shares					

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United Security Bancshares and Subsidiaries
Consolidated Statements of Cash Flows (unaudited)

(In thousands)	Six months ended June 30, 2018	2017
Cash Flows From Operating Activities:		
Net Income	$6,549	$4,263
Adjustments to reconcile net income: to cash provided by operating activities:		
Recovery of provision for credit losses	(1,325)	(31)
Depreciation and amortization	666	654
Amortization of investment securities	261	278
Accretion of investment securities	(3)	(4)
Increase in accrued interest receivable	(1,866)	(1,191)
Decrease in accrued interest payable	(1)	(43)
Decrease in accounts payable and accrued liabilities	(1,401)	(398)
Decrease in unearned fees and unamortized loan origination costs, net	684	152
Increase in income taxes receivable	(1,204)	(1,319)
Unrealized loss on marketable equity securities	78	—
Stock-based compensation expense	429	60
Provision for deferred income taxes	(108)	(247)
Gain on sale of other real estate owned	—	(336)
Gain on bank owned life insurance	(171)	—
Increase in cash surrender value of bank-owned life insurance	(257)	(266)
Loss on fair value option of financial liabilities	661	601
Loss on tax credit limited partnership interest	9	119
Gain on sale of premises and equipment	(29)	—
Net increase in other assets	(28)	(42)
Net cash provided by operating activities	2,944	2,250
Cash Flows From Investing Activities:		
Net increase in interest-bearing deposits with banks	—	(2)
Purchase of correspondent bank stock	(10)	(495)
Purchases of available-for-sale securities	(19,860)	—
Principal payments of available-for-sale securities	4,698	4,112
Net decrease in loans	27,839	2,654
Cash proceeds from sales of other real estate owned	—	1,062
Investment in limited partnership	—	(1,028)
Proceeds from bank owned life insurance	376	—
Capital expenditures of premises and equipment	(542)	(919)
Net cash provided by investing activities	12,501	5,384
Cash Flows From Financing Activities:		
Net increase in demand deposits and savings accounts	67,299	24,885
Net increase (decrease) in time deposits	1,970	(35,203)
Proceeds from exercise of stock options	—	6
Dividends on common stock	(1,520)	(846)
Net cash provided by (used in) financing activities	67,749	(11,158)

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Net increase (decrease) in cash and cash equivalents	83,194	(3,524)
Cash and cash equivalents at beginning of period	107,934	113,032
Cash and cash equivalents at end of period	$191,128	$109,508

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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 one bank subsidiary, USB Investment Trust (the "REIT") (collectively the "Company" or "USB"). Intercompany accounts and transactions have been eliminated in consolidation.

These unaudited financial statements have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial information on a basis consistent with the accounting policies reflected in the audited financial statements of the Company included in its 2017 Annual Report on Form 10-K. These interim financial statements do not include all of the information and footnotes required by GAAP 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.

Revenue from Contracts with Customers:

The Company records revenue from contracts with customers in accordance with Accounting Standards Codification Topic 606, "Revenue from Contracts with Customers" ("Topic 606"). Under Topic 606, the Company must identify the contract with a customer, identify the performance obligations in the contract, determine the transaction price, allocate the transaction price to the performance obligations in the contract, and recognize revenue when (or as) the Company satisfies a performance obligation.

The Company's primary sources of revenue are derived from interest and dividends earned on loans, investment securities, and other financial instruments that are not within the scope of Topic 606. The Company has evaluated the nature of its contracts with customers and determined that further disaggregation of revenue from contracts with customers into more granular categories beyond what is presented in the Consolidated Statements of Income was not necessary. The Company generally fully satisfies its performance obligations on its contracts with customers as services are rendered and the transaction prices are typically fixed; charged either on a periodic basis or based on activity. Because performance obligations are satisfied as services are rendered and the transaction prices are fixed, there is little judgment involved in applying Topic 606 that significantly affects the determination of the amount and timing of revenue from contracts with customers. The Company adopted Topic 606 using the modified retrospective method on all contracts not completed as of January 1, 2018. The adoption of Topic 606 did not result in a material change to the accounting for any of the in-scope revenue streams. As such, no cumulative effect adjustment was recorded.

Recently Issued Accounting Standards:

In January 2016, the FASB issued ASU No. 2016-01, "Financial Instruments – Overall: Recognition and Measurement of Financial Assets and Financial Liabilities" ("ASU 2016-01"). The guidance affects the accounting for equity investments, financial liabilities under the fair value option and the presentation and disclosure requirements of financial instruments. ASU 2016-01 was effective for the Company on January 1, 2018 and resulted in separate classification of equity securities previously included in available for sale securities on the consolidated balance sheets with changes in the fair value of the equity securities captured in the consolidated statements of income. See Note 2 – Investment Securities for disclosures related to equity securities. Adoption of the standard also resulted in the use of an exit price rather than an entrance price to determine the fair value of loans not measured at fair value on a non-recurring basis in the consolidated balance sheets. See Note 11 – Fair Value Disclosures for further information regarding the valuation of these loans. Additionally, adoption of the standard resulted in separately recognizing the

instrument-specific credit risk associated with the Company's Junior Subordinated Debt. See Note 10 - Junior Subordinated Debt / Trust Preferred Securities for additional information.

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. This ASU will be effective for public business entities for annual periods beginning after December 15, 2018 (i.e., calendar periods beginning on January 1, 2019), and interim periods therein. Although an estimate of the impact of the new leasing standard has not yet been determined, the Company expects a significant new lease asset and related lease liability on the consolidated balance sheet due to the number of leased branches and standalone ATM sites the Company currently has that are accounted for

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under current operating lease guidance. The Company has implemented a lease review team and is in the process of determining the best vendor to assist in the calculation and implementation of this standard.

In June 2016, FASB issued ASU 2016-13, Financial Instruments- Credit Losses (Topic 326). The FASB is issuing this Update to improve financial reporting by requiring timelier recording of credit losses on loans and other financial instruments held by financial institutions and other organizations. The Update requires enhanced disclosures and judgments in estimating credit losses and also amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. This amendment is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The Company has established a project team for the implementation of this new standard. The team has started by working with a vendor to put a new Allowance for Loan Loss software in place and is collecting additional historical data to estimate the impact of this standard. An estimate of the impact of this standard has not yet been determined, however, the impact on the Company's consolidated financial statements is expected to be significant.

In January 2017, FASB issued ASU 2017-04, Intangibles - Goodwill and Other (Topic 350). The FASB is issuing this Update to eliminate the requirement to calculate the implied fair value of goodwill to measure a goodwill impairment charge. Instead, entities will record an impairment charge based on the excess of a reporting unit's carrying amount over its fair value. This ASU will be effective for public business entities for annual periods beginning after December 15, 2019 (i.e. calendar periods beginning on January 1, 2020, and interim periods therein. The Company does not expect any impact on the Company's consolidated financial statements resulting from the adoption of this Update.

In March 2017, FASB issued ASU 2017-08 - Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities. The provisions of the update require premiums recognized upon the purchase of callable debt securities to be amortized to the earliest call date in order to avoid losses recognized upon call. For public business entities that are SEC filers the amendments of the update will become effective in fiscal years beginning after December 15, 2018. The Company does not expect the requirements of this Update to have a material impact on the Company’s financial position, results of operations or cash flows.

2. Investment Securities

Following is a comparison of the amortized cost and fair value of securities available-for-sale, as of June 30, 2018 and December 31, 2017:

(in 000's) June 30, 2018 Securities available for sale:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value (Carrying Amount)
U.S. Government agencies	$ 30,327	$ 182	$ (158)	$ 30,351
U.S. Government sponsored entities & agencies collateralized by mortgage obligations	26,914	37	(578)	26,373
Total securities available for sale	$ 57,241	$ 219	$ (736)	$ 56,724
(in 000's) December 31, 2017 Securities available for sale:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value (Carrying Amount)
U.S. Government agencies	$ 19,683	$ 312	$ (41)	$ 19,954
U.S. Government sponsored entities & agencies collateralized by mortgage obligations	22,391	56	(416)	22,031
Total securities available for sale	$ 42,074	$ 368	$ (457)	$ 41,985

The amortized cost and fair value of securities available for sale at June 30, 2018, 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.

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(in 000's)	June 30, 2018 Amortized Cost	Fair Value (Carrying Amount)
Due in one year or less	$—	$ —
Due after one year through five years	—	—
Due after five years through ten years	6,045	6,031
Due after ten years	24,282	24,320
Collateralized mortgage obligations	26,914	26,373
	$57,241	$ 56,724

There were no realized gains or losses on sales of available-for-sale securities for the three and six month periods ended June 30, 2018 and June 30, 2017. There were no other-than-temporary impairment losses for the three and six month periods ended June 30, 2018 and June 30, 2017.

At June 30, 2018, available-for-sale securities with an amortized cost of approximately $50,806,841 (fair value of $50,240,058) were pledged as collateral for FHLB borrowings, securitized deposits, and public funds balances.

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.

The following summarizes temporarily impaired investment securities:

(in 000's)	Less than 12 Months		12 Months or More		Total	
June 30, 2018	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	$12,673	$ (55)	7,464	(103)	$20,137	$ (158)
U.S. Government sponsored entities & agencies collateralized by mortgage obligations	7,188	(204)	12,134	(374)	19,322	(578)
Total impaired securities	$19,861	$ (259)	$19,598	$ (477)	$39,459	$ (736)
December 31, 2017						
Securities available for sale:						
U.S. Government agencies	$1,728	$ (3)	$6,625	$ (38)	$8,353	$ (41)
U.S. Government sponsored entities & agencies collateralized by mortgage obligations	7,483	(154)	13,583	(262)	21,066	(416)
Total impaired securities	$9,211	$ (157)	$20,208	$ (300)	$29,419	$ (457)

Temporarily impaired securities at June 30, 2018, were comprised of seven U.S. government agency securities, and twelve U.S. government sponsored entities and agencies collateralized by mortgage obligations securities.

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

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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 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 June 30, 2018, the decline in fair value of the seven U.S. government agency securities, and the twelve U.S. government sponsored entities and agencies collateralized by mortgage obligations 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 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 June 30, 2018.

As of December 31, 2017, marketable equity securities with a fair value of $3,737,000 were recorded within investment securities available for sale with unrealized losses recorded through comprehensive income and accumulated other comprehensive income. As of January 1, 2018, the Company adopted Accounting Standard Update ("ASU") 2016-01 and reclassified its marketable equity securities from investments available for sale into a separate component of investment securities. The ASU requires marketable equity securities to be reported at fair value with changes recorded through earnings. As of January 1, 2018, unrealized losses of $184,000 were reclassified from accumulated other comprehensive income to retained earnings.

During the six months ended June 30, 2018, the Company recognized $78,000 of unrealized losses related to equity securities held at June 30, 2018 in the consolidated statements of income. For the quarter ended June 30, 2018, the Company recognized $18,000 of unrealized losses related to equity securities held at June 30, 2018 in the consolidated

statements of income. The resulting impact on basic and diluted earnings per share for the quarter and six months ended June 30, 2018 is immaterial.

The Company had no held-to-maturity or trading securities at June 30, 2018 or December 31, 2017.

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3. Loans

Loans are comprised of the following:

(in 000's)	June 30, 2018	December 31, 2017
Commercial and Business Loans	$57,047	$ 46,065
Government Program Loans	908	961
Total Commercial and Industrial	57,955	47,026
Real Estate – Mortgage:		
Commercial Real Estate	212,513	221,032
Residential Mortgages	70,512	84,804
Home Improvement and Home Equity loans	386	457
Total Real Estate Mortgage	283,411	306,293
Real Estate Construction and Development	108,571	122,970
Agricultural	56,662	59,481
Installment and Student Loans	67,397	65,581
Total Loans	$573,996	$ 601,351

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 10.1% of total loans at June 30, 2018 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 49.4% of total loans at June 30, 2018, 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 and or guarantor(s).

- Commercial real estate mortgage loans comprise the largest segment of this loan category and are available on all types of income producing and non-income producing 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. 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.

- Home Improvement and Home Equity loans comprise a relatively small portion of total real estate mortgage loans. 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 18.9% of total loans at June 30, 2018, 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 or from the sale of the constructed homes to individuals.

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Agricultural loans represent 9.9% of total loans at June 30, 2018 and are generally secured by land, equipment, inventory and receivables. Repayment is from the cash flow of the borrower.

Installment loans, including student loans, represent 11.7% of total loans at June 30, 2018 and generally consist of student loans, loans to individuals for household, family and other personal expenditures, automobiles or other consumer items. Included in installment loans are $61,761,000 in unsecured student loans made to medical and pharmacy school students. Upon graduation the loan is automatically placed on deferment for 6 months. This may be extended up to 48 months for graduates enrolling in Internship, Medical Residency or Fellowship. As approved the student may receive additional deferment for hardship or administrative reasons in the form of forbearance for a maximum of 24 months throughout the life of the loan. Accrued interest on loans that have not entered repayment status totaled $6,186,000 at June 30, 2018. At June 30, 2018 there were 316 loans within repayment, deferment, and forbearance which represented $6,129,000, $1,270,000, and $3,006,000 in outstanding balances respectively. Prior to June 2018, student loans were insured through a Surety Bond issued by ReliaMax Surety Company and provided the Company reasonable expectation of collection. In June 2018, ReliaMax Surety Company was declared insolvent by the South Dakota Division of Insurance and is now in liquidation. As a result of the insolvency, the Company's student loan portfolio is no longer insured.

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 June 30, 2018 and December 31, 2017, these financial instruments include commitments to extend credit of $123,711,000 and $99,958,000, respectively, and standby letters of credit of $605,000 and $2,058,000, 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.

During the second quarter of 2018, the Bank entered into a Small Business Administration (SBA) 504 Loan Forward Purchase Commitment to buy a one hundred percent (100%) interest in up to $30 million, first mortgage, California SBA 504 loans on a flow basis with servicing released by the Seller.

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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 June 30, 2018 (in 000's):

June 30, 2018	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	$ —	$ —	$ —	$ —	$ 57,047	$ 57,047	$ —
Government Program Loans	—	—	—	—	908	908	—
Total Commercial and Industrial	—	—	—	—	57,955	57,955	—
Commercial Real Estate Loans	—	—	—	—	212,513	212,513	—
Residential Mortgages	—	—	—	—	70,512	70,512	—
Home Improvement and Home Equity Loans	—	—	—	—	386	386	—
Total Real Estate Mortgage	—	—	—	—	283,411	283,411	—
Real Estate Construction and Development Loans	—	—	8,825	8,825	99,746	108,571	—
Agricultural Loans	—	—	—	—	56,662	56,662	—
Consumer Loans	231	83	—	314	66,929	67,243	67
Overdraft Protection Lines	—	—	—	—	38	38	—
Overdrafts	—	—	—	—	116	116	—
Total Installment	231	83	—	314	67,083	67,397	67
Total Loans	$ 231	$ 83	$ 8,825	$ 9,139	$ 564,857	$ 573,996	$ 67

The following is a summary of delinquent loans at December 31, 2017 (in 000's):

December 31, 2017	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	$ —	$ —	$ 212	$ 212	$ 45,853	$ 46,065	$ —
Government Program Loans	—	—	—	—	961	961	—
Total Commercial and Industrial	—	—	212	212	46,814	47,026	—
Commercial Real Estate Loans	779	—	—	779	220,253	221,032	—
Residential Mortgages	—	—	94	94	84,710	84,804	—
Home Improvement and Home Equity Loans	—	—	—	—	457	457	—
Total Real Estate Mortgage	779	—	94	873	305,420	306,293	—
Real Estate Construction and Development Loans	—	—	360	360	122,610	122,970	360
Agricultural Loans	—	—	—	—	59,481	59,481	—
Consumer Loans	—	—	—	—	65,446	65,446	125
Overdraft Protection Lines	—	—	—	—	38	38	—
Overdrafts	—	—	—	—	97	97	—

Total Installment	—	—	—	—	65,581	65,581	125
Total Loans	$ 779	$ —	$ 666	$ 1,445	$ 599,906	$ 601,351	$ 485

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Nonaccrual Loans

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

- When there is doubt regarding the full repayment of interest and principal.

- When principal and/or interest on the loan has been in default for a period of 90-days or more, unless the asset is both well secured and in the process of collection that will result in repayment in the near future.

- When the loan is identified as having loss elements and/or is risk rated "8" Doubtful.

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

Loans meeting any of the preceding criteria are placed on 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 $12,202,000 and $5,296,000 at June 30, 2018 and December 31, 2017, respectively. Two loans were added to nonaccrual during the quarter ended June 30, 2018. Those loans, totaling $8,825,000, were made to the same borrower and are well-secured by real estate collateral. There were no remaining undisbursed commitments to extend credit on nonaccrual loans at June 30, 2018 or December 31, 2017.

The following is a summary of nonaccrual loan balances at June 30, 2018 and December 31, 2017 (in 000's).

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	June 30, 2018	December 31, 2017
Commercial and Business Loans	$—	$ 212
Government Program Loans	—	—
Total Commercial and Industrial	—	212
Commercial Real Estate Loans	438	454
Residential Mortgages	—	288
Home Improvement and Home Equity Loans	—	—
Total Real Estate Mortgage	438	742
Real Estate Construction and Development Loans	11,764	4,342
Agricultural Loans	—	—
Consumer Loans	—	—
Overdraft Protection Lines	—	—
Overdrafts	—	—
Total Installment	—	—
Total Loans	$12,202	$ 5,296

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.

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- 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.

The following is a summary of impaired loans at June 30, 2018 (in 000's).

June 30, 2018	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	$ 2,937	$ 535	$ 2,414	$ 2,949	$ 444	$ 3,171	$ 97
Government Program Loans	308	309	—	309	—	226	10
Total Commercial and Industrial	3,245	844	2,414	3,258	444	3,397	107
Commercial Real Estate Loans	1,362	—	1,367	1,367	510	1,409	34
Residential Mortgages	2,219	400	1,828	2,228	80	2,604	60
Home Improvement and Home Equity Loans	—	—	—	—	—	—	—
Total Real Estate Mortgage	3,581	400	3,195	3,595	590	4,013	94
Real Estate Construction and Development Loans	11,764	11,764	—	11,764	—	7,447	205
Agricultural Loans	1,010	1	1,016	1,017	706	1,112	43
Consumer Loans	62	62	—	62	—	49	3
Overdraft Protection Lines	—	—	—	—	—	—	—
Overdrafts	—	—	—	—	—	—	—
Total Installment	62	62	—	62	—	49	3
Total Impaired Loans	$ 19,662	$ 13,071	$ 6,625	$ 19,696	$ 1,740	$ 16,018	$ 452

(1) The recorded investment in loans includes accrued interest receivable of $34.
(2) Information is based on the six month period ended June 30, 2018.

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The following is a summary of impaired loans at December 31, 2017 (in 000's).

December 31, 2017	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	$ 3,255	$ 381	$ 2,887	$ 3,268	$ 534	$ 3,791	$ 229
Government Program Loans	49	50	—	50	—	219	5
Total Commercial and Industrial	3,304	431	2,887	3,318	534	4,010	234
Commercial Real Estate Loans	1,233	—	1,245	1,245	385	1,138	79
Residential Mortgages	3,040	1,199	1,852	3,051	103	2,745	142
Home Improvement and Home Equity Loans	—	—	—	—	—	—	—
Total Real Estate Mortgage	4,273	1,199	3,097	4,296	488	3,883	221
Real Estate Construction and Development Loans	5,951	5,972	—	5,972	—	6,660	418
Agricultural Loans	1,200	1	1,203	1,204	866	1,179	48
Consumer Loans	—	—	—	—	—	241	—
Overdraft Protection Lines	—	—	—	—	—	—	—
Overdrafts	—	—	—	—	—	—	—
Total Installment	—	—	—	—	—	241	—
Total Impaired Loans	$ 14,728	$ 7,603	$ 7,187	$ 14,790	$ 1,888	$ 15,973	$ 921

(1) The recorded investment in loans includes accrued interest receivable of $62.
(2) Information is based on the twelve month period ended December 31, 2017.

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 quarters ended June 30, 2018 and 2017 was $16,633,000 and $16,881,000, respectively. Interest income recognized on impaired loans for the quarters ended June 30, 2018 and 2017 was approximately $282,000 and $323,000, respectively. For impaired nonaccrual loans, interest income recognized under a cash-basis method of accounting was approximately $150,000 and $111,000 for the quarters ended June 30, 2018 and 2017, respectively.

The average recorded investment in impaired loans for the six months ended June 30, 2018 and 2017 was $16,018,000 and $16,468,000, respectively. Interest income recognized on impaired loans for the six months ended June 30, 2018 and 2017 was approximately $452,000 and $546,000, respectively. For impaired nonaccrual loans, interest income recognized under a cash-basis method of accounting was approximately $213,000 and $190,000 for the six months ended June 30, 2018 and 2017, respectively.

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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 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 and continued satisfactory performance is expected. To this end, the Company typically 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 additions for the periods indicated:

($ in 000's)	Three Months Ended June 30, 2018				
	Number of Contracts	Pre-Modification 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	—	$ —	$ —	—	$ —
Government Program Loans	—	—	—	—	—
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	—$	—$	——	$	—

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($ in 000's)	Three Months Ended June 30, 2017				
	Number of Contracts	Pre-Modification 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	—	$ —	$ —	—	$ —
Government Program Loans	1	178	178	—	—
Commercial Real Estate Term Loans	—	—	—	—	—
Single Family Residential Loans	1	238	238	—	—
Home Improvement and Home Equity Loans	—	—	—	—	—
Real Estate Construction and Development Loans	—	—	—	—	—
Agricultural Loans	—	—	—	—	—
Consumer Loans	—	—	—	—	—
Overdraft Protection Lines	—	—	—	—	—
Total Loans	2	$ 416	$ 416	—	$ —

($ in 000's)	Six Months Ended June 30, 2018				
	Number of Contracts	Pre-Modification 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	—	$ —	$ —	—	$ —
Government Program Loans	—	—	—	—	—
Commercial Real Estate Term Loans	—	—	—	—	—
Single Family Residential Loans	—	—	—	—	—
Home Improvement and Home Equity Loans	—	—	—	—	—
Real Estate Construction and Development Loans	—	—	—	1	310
Agricultural Loans	—	—	—	—	—
Consumer Loans	—	—	—	—	—
Overdraft Protection Lines	—	—	—	—	—
Total Loans	—	$ —	$ —	1	$ 310

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($ in 000's)	Six Months Ended June 30, 2017 Number of Contracts	Pre-Modification 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	1	$ 69	$ 69	—	$ —
Government Program Loans	1	178	178	—	—
Commercial Real Estate Term Loans	—	—	—	—	—
Single Family Residential Loans	1	238	238	—	—
Home Improvement and Home Equity Loans	—	—	—	—	—
Real Estate Construction and Development Loans	1	790	790	—	—
Agricultural Loans	1	850	850	—	—
Consumer Loans	—	—	—	—	—
Overdraft Protection Lines	—	—	—	—	—
Total Loans	5	$ 2,125	$ 2,125	—	$ —

The Company makes various types of concessions when structuring TDRs including rate discounts, payment extensions, and forbearance. At June 30, 2018, the Company had 17 restructured loans totaling $7,641,000 as compared to 25 restructured loans totaling $11,362,000 at December 31, 2017.

The following tables summarize TDR activity by loan category for the quarters ended June 30, 2018 and June 30, 2017 (in 000's).

Three Months Ended June 30, 2018	Commercial and Industrial	Commercial Real Estate	Residential Mortgages	Home Improvement and Home Equity	Real Estate Construction Development	Agricultural	Installment & Other	Total
Beginning balance	$ 147	$ 1,314	$ 2,525	$ —	$ 4,606	$ 1,110	$ —	$ 9,702
Defaults	—	—	—	—	—	—	—	—
Additions	—	—	—	—	—	—	—	—
Principal (reductions) additions	(37)	48	(305)	—	(1,667)	(100)	—	(2,061)
Charge-offs	—	—	—	—	—	—	—	—
Ending balance	$ 110	$ 1,362	$ 2,220	$ —	$ 2,939	$ 1,010	$ —	$ 7,641
Allowance for loan loss	$ —	$ 511	$ 80	$ —	$ —	$ 706	$ —	$ 1,297

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Three Months Ended June 30, 2017	Commercial and Industrial	Commercial Real Estate	Residential Mortgages	Home Improvement and Home Equity	Real Estate Construction Development	Agricultural	Installment & Other	Total
Beginning balance	$ 1,212	$ 1,091	$ 2,351	$ —	$ 6,960	$ 850	$ 965	$ 13,429
Defaults	—	—	—	—	—	—	—	—
Additions	178	—	238	—	—	—	—	416
Principal reductions	(332)	(29)	(16)	—	(92)	(450)	(965)	(1,884)
Charge-offs	(3)	—	—	—	—	—	—	
Ending balance	$ 1,055	$ 1,062	$ 2,573	$ —	$ 6,868	$ 400	$ —	$ 11,958
Allowance for loan loss	$ 36	$ 216	$ 207	$ —	$ —	$ 203	$ —	$ 662

The following tables summarize TDR activity by loan category for the six months ended June 30, 2018 and June 30, 2017 (in 000's).

Six Months Ended June 30, 2018	Commercial and Industrial	Commercial Real Estate	Residential Mortgages	Home Improvement and Home Equity	Real Estate Construction Development	Agricultural	Installment & Other	Total
Beginning balance	$ 436	$ 1,233	$ 2,542	$ —	$ 5,951	$ 1,200	$ —	$ 11,362
Defaults	—	—	—	—	(310)	—	—	(310)
Additions	—	—	—	—	—	—	—	—
Principal reductions	(263)	129	(322)	—	(2,702)	(190)	—	(3,348)
Charge-offs	(63)	—	—	—	—	—	—	(63)
Ending balance	$ 110	$ 1,362	$ 2,220	$ —	$ 2,939	$ 1,010	$ —	$ 7,641
Allowance for loan loss	$ —	$ 511	$ 80	$ —	$ —	$ 706	$ —	$ 1,297

Six Months Ended June 30, 2017	Commercial and Industrial	Commercial Real Estate	Residential Mortgages	Home Improvement and Home Equity	Real Estate Construction Development	Agricultural	Installment & Other	Total
Beginning balance	$ 1,356	$ 1,454	$ 2,368	$ —	$ 6,267	$ —	$ 965	$ 12,410
Defaults	—	—	—	—	—	—	—	—
Additions	247	—	238	—	790	850	—	2,125
Principal additions (reductions)	(538)	(392)	(33)	—	(189)	(450)	(965)	(2,567)
Charge-offs	(10)	—	—	—	—	—	—	(10)

Ending balance	$ 1,055	$ 1,062	$ 2,573	$ —	$ 6,868	$ 400	$ —	$ 11,958
Allowance for loan loss	$ 36	$ 216	$ 207	$ —	$ —	$ 203	$ —	$ 662

Credit Quality Indicators

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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 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
- 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-

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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.

- 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 June 30, 2018 or December 31, 2017.

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The following tables summarize the credit risk ratings for commercial, construction, and other non-consumer related loans for June 30, 2018 and December 31, 2017:

June 30, 2018 (in 000's)	Commercial and Industrial	Commercial Real Estate	Real Estate Construction and Development	Agricultural	Total
Grades 1 and 2	$ 325	$ 2,924	$ —	$ —	$3,249
Grade 3	217	1,067	—	—	1,284
Grades 4 and 5 – pass	54,230	199,707	85,057	55,652	394,646
Grade 6 – special mention	10	8,376	—	—	8,386
Grade 7 – substandard	3,173	439	23,514	1,010	28,136
Grade 8 – doubtful	—	—	—	—	—
Total	$ 57,955	$ 212,513	$ 108,571	$ 56,662	$435,701

December 31, 2017 (in 000's)	Commercial and Industrial	Commercial Real Estate	Real Estate Construction and Development	Agricultural	Total
Grades 1 and 2	$ 342	$ 2,954	$ —	$ 70	$3,366
Grade 3	251	1,569	—	—	1,820
Grades 4 and 5 – pass	43,264	207,568	104,549	56,817	412,198
Grade 6 – special mention	—	8,487	720	994	10,201
Grade 7 – substandard	3,169	454	17,701	1,600	22,924
Grade 8 – doubtful	—	—	—	—	—
Total	$ 47,026	$ 221,032	$ 122,970	$ 59,481	$450,509

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 June 30, 2018 and December 31, 2017:

	June 30, 2018				December 31, 2017			
(in 000's)	Residential Mortgages	Home Improvement and Home Equity	Installment and Other	Total	Residential Mortgages	Home Improvement and Home Equity	Installment and Other	Total
Not graded	$60,242	$ 364	$ 65,178	$125,784	$69,249	$ 433	$ 63,565	$133,247
Pass	9,415	22	2,156	11,593	13,899	24	2,011	15,934
Special Mention	636	—	—	636	643	—	—	643
Substandard	219	—	63	282	1,013	—	5	1,018
Doubtful	—	—	—	—	—	—	—	—
Total	$70,512	$ 386	$ 67,397	$138,295	$84,804	$ 457	$ 65,581	$150,842

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The following tables summarize the credit quality indicators for outstanding student loans as of June 30, 2018 and December 31, 2017 (in 000's, except for number of borrowers):

	June 30, 2018		December 31, 2017	
	Number of Loans	Amount (in 000's)	Number of Loans	Amount (in 000's)
School	992	$37,565	1,216	$48,825
Grace	294	13,724	55	1,446
Repayment	184	6,129	201	6,473
Deferment	40	1,270	32	1,128
Forbearance	92	3,006	50	1,981
Claim	1	67	—	—
Total	1,603	$61,761	1,554	$59,853

School - The time in which the borrower is still actively in school at least half time. No payments are expected during this stage, though the borrower may begin immediate payments.

Grace - A six month period of time granted to the borrower immediately upon graduation, or if deemed no longer an active student. Interest continues to accrue. Upon completion of the six month grace period the loan is transferred to repayment status. Additionally, if applicable, this status may represent a borrower activated to military duty while in their in-school period, they will be allowed to return to that status once their active duty has expired. The borrower must return to an at least half time status within six months of the active duty end date in order to return to an in-school status.

Repayment - The time in which the borrower is no longer actively in school at least half time, and has not received an approved grace, deferment, or forbearance. Regular payment is expected from these borrowers under an allotted payment plan.

Deferment - May be granted up to 48 months for borrowers who have begun the repayment period on their loans but are (1) actively enrolled in an eligible school at least half time, or (2) are actively enrolled in an approved and verifiable medical residency, internship, or fellowship program.

Forbearance - The period of time during which the borrower may postpone making principal and interest payments, which may be granted for either hardship or administrative reasons. Interest will continue to accrue on loans during periods of authorized forbearance. If the borrower is delinquent at the time the forbearance is granted, the delinquency will be covered by the forbearance and all accrued and unpaid interest from the date of delinquency or if none, from the date of beginning of the forbearance period, will be capitalized at the end of each forbearance period. The term of the loan will not change and payments may be increased to allow the loan to pay off in the required time frame.

Claim - Occurs after a loan has been delinquent for a period of time in which the servicer believes payment may not be received. A claim can be filed at any point in the delinquency, but typically not until 180 - 210 days. ReliaMax Surety Company was declared insolvent by the South Dakota Division of Insurance and is now in liquidation. No future claims will be filed with ReliaMax.

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

ten 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 their 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

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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 sixteen quarters are isolated to approximately seven 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 –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.

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 and other loans (Includes consumer loans, student loans, overdrafts, and overdraft protection lines) – This segment is higher risk because many of the loans are unsecured. Additionally, in the case of student loans, there are increased risks associated with liquidity as there is a significant time lag between funding of a student loan and eventual repayment. The Company is still evaluating the impact of ReliaMax's insolvency and the elimination of the Surety Bond on the Company's allowance for loan loss related to student loans.

The following summarizes the activity in the allowance for credit losses by loan category for the quarters ended June 30, 2018 and 2017 (in 000's).

Three Months Ended June 30, 2018	Commercial and Industrial	Real Estate Mortgage	Real Estate Construction Development	Agricultural	Installment & Other	Unallocated	Total
Beginning balance	$ 1,985	$ 1,204	$ 2,862	$ 1,342	$ 821	$ 902	$ 9,116
Provision (recovery of provision) for credit losses	(793)	(7)	(175)	(41)	(55)	(65)	(1,136)
Charge-offs	—	—	—	—	(7)	—	(7)
Recoveries	355	16	—	—	81	—	452
Net charge-offs	355	16	—	—	74	—	445
Ending balance	$ 1,547	$ 1,213	$ 2,687	$ 1,301	$ 840	$ 837	$ 8,425
Period-end amount allocated to:							
Loans individually evaluated for impairment	444	590	—	706	—	—	1,740
Loans collectively evaluated for impairment	1,103	623	2,687	595	840	837	6,685
Ending balance	$ 1,547	$ 1,213	$ 2,687	$ 1,301	$ 840	$ 837	$ 8,425

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Three Months Ended June 30, 2017	Commercial and Industrial	Real Estate Mortgage	Real Estate Construction Development	Agricultural	Installment & Other	Unallocated	Total
Beginning balance	$ 1,781	$ 1,285	$ 3,096	$ 1,097	$ 848	$ 841	$ 8,948
Provision (recovery of provision) for credit losses	(72)	(118)	(209)	492	(92)	(53)	(52)
Charge-offs	(98)	—	—	—	(5)	—	(103)
Recoveries	154	7	—	—	53	—	214
Net charge-offs	56	7	—	—	48	—	111
Ending balance	$ 1,765	$ 1,174	$ 2,887	$ 1,589	$ 804	$ 788	$ 9,007
Period-end amount allocated to:							
Loans individually evaluated for impairment	711	441	—	793	—	—	1,945
Loans collectively evaluated for impairment	1,054	733	2,887	796	804	788	7,062
Ending balance	$ 1,765	$ 1,174	$ 2,887	$ 1,589	$ 804	$ 788	$ 9,007

The following summarizes the activity in the allowance for credit losses by loan category for the six months ended June 30, 2018 and 2017 (in 000's).

Six Months Ended June 30, 2018	Commercial and Industrial	Real Estate Mortgage	Real Estate Construction Development	Agricultural	Installment & Other	Unallocated	Total
Beginning balance	$ 1,408	$ 1,182	$ 2,903	$ 1,631	$ 887	$ 1,256	$ 9,267
Provision (recovery of provision) for credit losses	(181)	11	(216)	(330)	(190)	(419)	(1,325)
Charge-offs	(88)	—	—	—	(11)	—	(99)
Recoveries	408	20	—	—	154	—	582
Net recoveries	320	20	—	—	143	—	483
Ending balance	$ 1,547	$ 1,213	$ 2,687	$ 1,301	$ 840	$ 837	$ 8,425
Period-end amount allocated to:							
Loans individually evaluated for impairment	444	590	—	706	—	—	1,740
Loans collectively evaluated for impairment	1,103	623	2,687	595	840	837	6,685
Ending balance	$ 1,547	$ 1,213	$ 2,687	$ 1,301	$ 840	$ 837	$ 8,425

Six Months Ended June 30, 2017	Commercial and Industrial	Real Estate Mortgage	Real Estate Construction Development	Agricultural	Installment & Other	Unallocated	Total
Beginning balance	$ 1,843	$ 1,430	$ 3,378	$ 666	$ 888	$ 697	$ 8,902
Provision (recovery of provision) for credit losses	(137)	(268)	(491)	902	(128)	91	(31)
Charge-offs	(105)	(2)	—	—	(10)	—	(117)
Recoveries	164	14	—	21	54	—	253
Net charge-offs	59	12	—	21	44	—	136

Ending balance	$ 1,765	$ 1,174	$ 2,887	$ 1,589	$ 804	$ 788	$9,007
Period-end amount allocated to:							
Loans individually evaluated for impairment	711	441	—	793	—	—	1,945
Loans collectively evaluated for impairment	1,054	733	2,887	796	804	788	7,062
Ending balance	$ 1,765	$ 1,174	$ 2,887	$ 1,589	$ 804	$ 788	$9,007

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The following summarizes information with respect to the loan balances at June 30, 2018 and 2017.

(in 000's)	June 30, 2018 Loans Individually Evaluated for Impairment	June 30, 2018 Loans Collectively Evaluated for Impairment	June 30, 2018 Total Loans	June 30, 2017 Loans Individually Evaluated for Impairment	June 30, 2017 Loans Collectively Evaluated for Impairment	June 30, 2017 Total Loans
Commercial and Business Loans	$2,949	$ 54,098	$57,047	$3,950	$ 47,128	$51,078
Government Program Loans	309	599	908	396	997	1,393
Total Commercial and Industrial	3,258	54,697	57,955	4,346	48,125	52,471
Commercial Real Estate Loans	1,367	211,146	212,513	1,066	201,298	202,364
Residential Mortgage Loans	2,228	68,284	70,512	2,678	76,641	79,319
Home Improvement and Home Equity Loans	—	386	386	—	572	572
Total Real Estate Mortgage	3,595	279,816	283,411	3,744	278,511	282,255
Real Estate Construction and Development Loans	11,764	96,807	108,571	6,878	117,871	124,749
Agricultural Loans	1,017	55,645	56,662	1,056	57,376	58,432
Installment and Other Loans	62	67,335	67,397	—	49,333	49,333
Total Loans	$19,696	$ 554,300	$573,996	$16,024	$ 551,216	$567,240

4. Deposits

Deposits include the following:

(in 000's)	June 30, 2018	December 31, 2017
Noninterest-bearing deposits	$281,686	$ 307,299
Interest-bearing deposits:		
NOW and money market accounts	322,995	234,154
Savings accounts	85,480	81,408
Time deposits:		
Under $250,000	51,925	51,687
$250,000 and over	14,877	13,145
Total interest-bearing deposits	475,277	380,394
Total deposits	$756,963	$ 687,693
Total brokered deposits included in time deposits above *	$—	$ —

* CDARs reciprocal deposits are no longer considered brokered deposits for the Company.

5. Short-term Borrowings/Other Borrowings

At June 30, 2018, the Company had collateralized lines of credit with the Federal Reserve Bank of San Francisco totaling $279,450,000, as well as Federal Home Loan Bank (FHLB) lines of credit totaling $4,687,000. At June 30, 2018, the Company had an uncollateralized line of credit with Pacific Coast Bankers Bank ("PCBB") totaling $10,000,000, a Fed Funds line of $10,000,000 with Union Bank, 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 June 30, 2018, $7,130,000 in investment securities at FHLB were pledged as collateral for FHLB advances. Additionally, $415,304,000 in

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secured and unsecured loans were pledged at June 30, 2018, as collateral for borrowing lines with the Federal Reserve Bank. At June 30, 2018, the Company had no outstanding borrowings.

At December 31, 2017, the Company had collateralized lines of credit with the Federal Reserve Bank of San Francisco totaling $305,236,000, as well as Federal Home Loan Bank ("FHLB") lines of credit totaling $13,363,000. At December 31, 2017, 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 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, 2017, $17,049,000 in investment securities at FHLB were pledged as collateral for FHLB advances. Additionally, $473,364,000 in secured and unsecured loans were pledged at December 31, 2017, as collateral for used and unused borrowing lines with the Federal Reserve Bank. At December 31, 2017, the Company had no outstanding borrowings.

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6. Supplemental Cash Flow Disclosures

(in 000's)	Six months ended June 30, 2018