

UNITED SECURITY BANCSHARES
Form 10-Q
May 16, 2011

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2011.
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM TO .

Commission file number: 000-32987

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

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

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

Indicate by check mark whether the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing for the past 90 days.

Yes No

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

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

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

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

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

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

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

Common Stock, no par value
(Title of Class)

Shares outstanding as of April 30, 2011: 13,133,871

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PART I. Financial Information

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

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

See notes to consolidated financial statements

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

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

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

See notes to consolidated financial statements

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

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

See notes to consolidated financial statements

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Consolidated Statements of Cash Flows (unaudited)

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

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

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

1. Organization and Summary of Significant Accounting and Reporting Policies

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

These unaudited financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information on a basis consistent with the accounting policies reflected in the audited financial statements of the Company included in its 2010 Annual Report on Form 10-K. These interim financial statements do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of a normal recurring, nature) considered necessary for a fair presentation have been included. Operating results for the interim periods presented are not necessarily indicative of the results that may be expected for any other interim period or for the year as a whole.

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

New Accounting Standards:

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

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

2. Investment Securities Available for Sale and Other Investments

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

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

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The amortized cost and fair value of securities available for sale at March 31, 2011, by contractual maturity, are shown below. Actual maturities may differ from contractual maturities because issuers have the right to call or prepay obligations with or without call or prepayment penalties. Contractual maturities on collateralized mortgage obligations cannot be anticipated due to allowed paydowns.

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

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

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

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

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

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

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

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

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

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

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

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

Other-than-temporary-impairment occurs under the new guidance when the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss. If an entity intends to sell or more likely than not will be required to sell the security before

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

At March 31, 2011, the decline in market value for all but three (see below) of the impaired securities is attributable to changes in interest rates, and not credit quality. Because the Company does not have the intent to sell these impaired securities and it is not more likely than not it will be required to sell the securities before their anticipated recovery, the Company does not consider these securities to be other-than-temporarily impaired at March 31, 2011.

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

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

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

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

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

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

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

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3. Loans and Leases

Loans are comprised of the following:

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

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

Commercial and industrial loans represent 37.4% of total loans at March 31, 2011 and are generally made to support the ongoing operations of small-to-medium sized commercial businesses. Commercial and industrial loans have a high degree of industry diversification and provide, working capital, financing for the purchase of manufacturing plants and equipment, or funding for growth and general expansion of businesses. A substantial portion of commercial and industrial loans are secured by accounts receivable, inventory, leases or other collateral including real estate. The remainder are unsecured; however, extensions of credit are predicated upon the financial capacity of the borrower. Repayment of commercial loans is generally from the cash flow of the borrower.

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

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

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

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

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

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

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

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

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

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

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

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

Past Due Loans

The Company monitors delinquency and potential problem loans on an ongoing basis through weekly reports to the Loan Committee and monthly reports to the Board of Directors. The following is a summary of delinquent loans at March 31, 2011:

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

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Total Commercial and Industrial							
Commercial Real Estate Term Loans	2,644	1,093	0	3,737	127,358	131,095	0
Single Family Residential Loans	1,194	0	424	1,618	22,061	23,679	328
Home Improvement and Home Equity Loans	147	37	18	202	2,088	2,290	0
Total Real Estate Mortgage	3,985	1,130	442	5,557	151,507	157,064	328
Total RE Construction and Development Loans							
	905	0	3,934	4,839	59,891	64,730	0
Total Agricultural Loans							
	0	0	560	560	35,718	36,278	450
Consumer Loans							
Overdraft protection Lines	67	85	41	193	12,227	12,420	0
Overdrafts	0	0	0	0	80	80	0
Total Installment/other	0	0	0	0	172	172	0
Commercial Lease Financing							
	67	85	41	193	12,479	12,672	0
Commercial Lease Financing							
	0	0	97	97	65	162	0
Total Loans	\$12,400	\$1,298	\$16,984	\$30,682	\$402,142	\$432,824	\$1,358

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Included in the loans above, are \$29.4 million in nonaccrual loans of which \$17.6 million are included in past due loans and \$11.8 million are included in current loans. Nonaccrual loans which have been restructured and which are performing according to the terms of the restructure agreement, including those for which payments are due at maturity, are considered current in the above table.

The following is a summary of delinquent loans at December 31, 2010:

December 31, 2010 (000's)	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	\$ 4,554	\$ 443	\$ 4,637	\$ 9,634	\$144,990	\$ 154,624	\$ 454
Government Program Loans	114	106	305	525	4,075	4,600	93
Total Commercial and Industrial	4,668	549	4,942	10,159	149,065	159,224	547
Commercial Real Estate Term Loans	0	0	1,405	1,405	130,227	131,632	0
Single Family Residential Loans	0	328	98	426	23,338	23,764	0
Home Improvement and Home Equity Loans	102	55	45	202	2,183	2,385	0
Total Real Estate Mortgage	102	383	1,548	2,033	155,748	157,781	0
Total RE Construction and Development Loans	4,004	3,395	1,630	9,029	56,153	65,182	0
Total Agricultural Loans	0	0	398	398	45,910	46,308	0
Consumer Loans	39	12	57	108	12,354	12,462	0
Overdraft protection Lines	0	0	0	0	74	74	0
Overdrafts	0	0	0	0	355	355	0
Total Installment/other	39	12	57	108	12,783	12,891	0
Commercial Lease Financing	0	0	0	0	305	305	0
Total Loans	\$ 8,813	\$ 4,339	\$ 8,575	\$ 21,727	\$419,964	\$ 441,691	\$ 547

Included in the loans above, are \$34.4 million in nonaccrual loans of which \$15.0 million are included in past due loans and \$19.4 million are included in current loans. Nonaccrual loans which have been restructured and which are performing according to the terms of the restructure agreement, including those for which payments are due at maturity, are considered current in the above table.

Nonaccrual Loans

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

- When there is doubt regarding the full repayment of interest and principal.
- When principal and/or interest on the loan has been in default for a period of 90-days or more, unless the asset is both well secured and in the process of collection that will result in repayment in the near future.
- When the loan is identified as having loss elements and/or is risk rated "8" Doubtful.
- Other circumstances which jeopardize the ultimate collectability of the loan including certain troubled debt restructurings, identified loan impairment, and certain loans to facilitate the sale of OREO.

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

Loans that are secured by one-to-four family residential properties (e.g., residential mortgage loans and home equity loans) on which principal and/or interest is due and unpaid for 90 days or more are placed on non-accrual and the accrual of interest for financial statement purposes is discontinued. Previously accrued but unpaid interest is reversed and charged against interest income.

Consumer loans to individuals for personal, family and household purposes, and unsecured or secured personal property where principal or interest is due and unpaid for 90 days or more are placed on non-accrual and the accrual of interest for financial statement purposes is discontinued. Previously accrued but unpaid interest is reversed and charged against interest income.

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

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

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

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

Nonaccrual loans totaled \$29.4 million and \$34.4 million at March 31, 2011 and December 31, 2010, respectively. There were no remaining undisbursed commitments to extend credit on nonaccrual loans at March 31, 2011 or December 31, 2010. During the three months ended March 31, 2011 and 2010, the Company recorded \$26,000 and \$3,000, respectively, in interest income on nonaccrual loans.

The following is a summary of nonaccrual loan balances at March 31, 2011 and December 31, 2010.

December 31, 2010 (000's)	March 31, 2011	December 31, 2010
Commercial and Business Loans	\$ 12,770	\$ 13,238
Government Program Loans	307	211
Total Commercial and Industrial	13,077	13,449
Commercial Real Estate Term Loans	1,327	1,405
Single Family Residential Loans	96	98
Home Improvement and Home Equity Loans	18	89
Total Real Estate Mortgage	1,441	1,592
Total RE Construction and Development Loans	14,439	16,003

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Total Agricultural Loans	292	3,107
Consumer Loans	52	68
Overdraft protection Lines	0	0
Overdrafts	0	0
Total Installment/other	52	68
Commercial Lease Financing	97	175
Total Loans	\$ 29,398	\$ 34,394

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Impaired Loans

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

The Company applies its normal loan review procedures in making judgments regarding probable losses and loan impairment. The Company evaluates for impairment those loans on non-accrual status, graded doubtful, graded substandard or those that are troubled debt restructures. The primary basis for inclusion in impaired status under 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.
- We expect to collect all amounts due, including interest accrued, at the contractual interest rate for the period of the delay.

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

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

- For loans secured by collateral including real estate and equipment the fair value of the collateral less selling costs will determine the carrying value of the loan. The difference between the recorded investment in the loan and the fair value, less selling costs, determines the amount of impairment. The Company uses the measurement method based on fair value of collateral when the loan is collateral dependent and foreclosure is probable.
- The discounted cash flow method of measuring the impairment of a loan is used for unsecured loans or for loans secured by collateral where the fair value cannot be easily determined. Under this method, the Company assesses both the amount and timing of cash flows expected from impaired loans. The estimated cash flows are discounted using the loan's effective interest rate. The difference between the amount of the loan on the Bank's books and the discounted cash flow amounts determines the amount of impairment to be provided. This method is used for most of the Company's troubled debt restructurings or other impaired loans where some payment stream is being collected.
- The observable market price method of measuring the impairment of a loan is only used by the Company when the sale of loans or a loan is in process.

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

Loans other than certain homogenous 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 when required.

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The following is a summary of impaired loans at March 31, 2011.

March 31, 2011 (000's)	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment
Commercial and Business Loans	\$17,573	\$413	\$15,209	\$15,622	\$4,739	\$15,149
Government Program Loans	307	174	133	307	133	259
Total Commercial and Industrial	17,880	587	15,342	15,929	4,872	15,408
Commercial Real Estate Term Loans	6,395	2,674	3,660	6,334	412	6,380
Single Family Residential Loans	3,649	784	2,562	3,346	232	3,353
Home Improvement and Home Equity Loans	142	91	18	109	4	124
Total Real Estate Mortgage	10,186	3,549	6,240	9,789	648	9,857
Total RE Construction and Development Loans	24,799	4,303	16,705	21,008	5,159	21,884
Total Agricultural Loans	3,169	218	1,579	1,797	256	2,452
Consumer Loans	232	76	153	229	35	189
Overdraft protection Lines	0	0	0	0	0	0
Overdrafts	0	0	0	0	0	0
Total Installment/other	232	76	153	229	35	189
Commercial Leases Financing	97	0	97	97	22	136
Total Impaired Loans	\$56,363	\$8,733	\$40,116	\$48,849	\$10,992	\$49,926

The following is a summary of impaired loans at December 31, 2010.

December 31, 2010 (000's)	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment
Commercial and Business Loans	\$16,317	\$520	\$14,156	\$14,676	\$4,974	\$10,338
Government Program Loans	317	179	32	211	32	307
Total Commercial and Industrial	16,634	699	14,188	14,887	5,006	10,645
Commercial Real Estate Term Loans	6,448	2,761	3,664	6,425	476	7,386
	3,660	443	2,916	3,359	241	3,528

Single Family Residential
Loans

Home Improvement and Home Equity Loans	143	93	45	138	27	101
Total Real Estate Mortgage	10,251	3,297	6,625	9,922	744	11,015
Total RE Construction and Development Loans	26,584	5,572	17,187	22,759	4,890	23,725
Total Agricultural Loans	4,143	160	2,947	3,107	686	4,141
Consumer Loans	150	148	0	148	0	255
Overdraft protection Lines	0	0	0	0	0	0
Overdrafts	0	0	0	0	0	0
Total Installment/other	150	148	0	148	0	255
Commercial Leases Financing	175	175	0	175	0	54
Total Impaired Loans	\$57,937	\$10,051	\$40,947	\$50,998	\$11,326	\$49,835

At March 31, 2011 and December 31, 2010, the Company's recorded investment in loans for which impairment has been recognized totaled \$48.8 million and \$51.0 million, respectively. Included in total impaired loans at March 31, 2011 are \$40.1 million of impaired loans for which the related specific allowance is \$11.0 million, as well as \$8.7 million of impaired loans that as a result of write-downs or the fair value of the collateral, did not have a specific allowance. Included in total impaired loans at December 31, 2010 are \$40.9 million of impaired loans for which the related specific allowance is \$11.3 million, as well as \$10.1 million of impaired loans that as a result of write-downs or the fair value of the collateral, did not have a specific allowance. The average recorded investment in impaired loans was \$49.9 million and \$49.8 million for the three months ended March 31, 2011 and the year ended December 31, 2010, respectively.

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The following table summarizes the Company's investment in loans for which impairment has been recognized for the three months ended March 31, 2010:

(in thousands)	March 31, 2010
Total impaired loans at period-end	\$51,932
Impaired loans which have specific allowance	32,938
Total specific allowance on impaired loans	9,339
Total impaired loans which as a result of write-downs or the fair value of the collateral, did not have a specific allowance	18,994
(in thousands)	YTD – 3/31/10
Average recorded investment in impaired loans during period	\$52,863
Income recognized on impaired loans during period	\$155

In most cases, the Company uses the cash basis method of income recognition for impaired loans. In the case of certain troubled debt restructuring for which the loan is performing under the current contractual terms for a reasonable period of time, income is recognized under the accrual method. For the three months ended March 31, 2011 and 2010, the Company recognized \$156,000 and \$155,000, respectively in interest income on impaired loans.

The Company grades "problem" or "classified" loans according to certain risk factors associated with individual loans within the loan portfolio. Classified loans consist of loans which have been graded substandard, doubtful, or loss based upon inherent weaknesses in the individual loans or loan relationships. Classified loans also include impaired loans (as defined under ACS Topic 310). The following table summarizes the Company's classified loans at March 31, 2011 and December 31, 2010.

(in 000's)	March 31, 2011	December 31, 2010
Impaired loans	\$48,849	\$50,998
Classified loans not considered impaired	4,494	2,585
Total classified loans	\$53,343	\$53,583

Troubled Debt Restructurings

Under the circumstances, when the Company grants a concession to a borrower as part of a loan restructuring, the restructuring is accounted for as a troubled debt restructuring (TDR). TDR's 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.

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- A modification of terms of a debt such as one or a combination of:
 - o The reduction (absolute or contingent) of the stated interest rate.
 - o 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.
 - o The reduction (absolute or contingent) of the face amount or maturity amount of the debt as stated in the instrument or agreement.
 - o The reduction (absolute or contingent) of accrued interest.

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

The following quantifies TDR's by type classified separately as accrual or nonaccrual at March 31, 2011.

(in thousands)	Number TDR's	Total March 31, 2011	Nonaccrual TDR's March 31, 2011	Accruing TDR's March 31, 2011
Commercial and industrial	17	\$5,031	\$2,360	\$2,671
Real estate - mortgage:				
Commercial real estate	6	5,007	0	5,007
Residential mortgages	11	3,250	0	3,250
Home equity loans	3	91	0	91
Total real estate mortgage	20	8,348	0	8,348
RE construction & development	12	13,070	10,504	2,566
Agricultural	0	0	0	0
Installment/other	3	163	0	163
Lease financing	0	0	0	0
Total Loans	52	\$26,612	\$12,864	\$13,748

The following quantifies TDR's by type classified separately as accrual or nonaccrual at December 31, 2010.

(in thousands)	Number TDR's	Total December 31, 2010	Nonaccrual TDR's December 31, 2010	Accruing TDR's December 31, 2010
Commercial and industrial	13	\$ 2,751	\$ 1,359	\$ 1,392
Real estate - mortgage:				
Commercial real estate	6	5,019	0	5,019
Residential mortgages	11	3,261	0	3,261
Home equity loans	3	93	43	50
Total real estate mortgage	20	8,373	43	8,330

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RE construction & development	13	13,730	10,978	2,752
Agricultural	0	0	0	0
Installment/other	2	80	0	80
Lease financing	0	0	0	0
Total Loans	48	\$ 24,934	\$ 12,380	\$ 12,554

The Company makes various types of concessions when structuring TDR's including rate reductions, payment extensions, and forbearance. At March 31, 2011, the Company had 52 restructured loans totaling \$26.6 million as compared to 48 restructured loans total \$24.9 million at December 31, 2010. At March 31, 2011, more than \$13.0 million of the total \$26.6 million in TDR's was for real estate construction and development, and there was another \$2.0 million and \$1.2 million related to real estate developers in commercial real estate and commercial and industrial, respectively at March 31, 2011. The majority of these credits are related to real estate construction projects that slowed significantly or stalled during the past several years, and the Company has sought to restructure the credits to allow the construction industry time to recover, and the developers time to finish projects at a slower pace which reflects current market conditions in the San Joaquin Valley. Concessions granted in these circumstances include lengthened maturity terms, lower lot release prices, or rate reductions that will enable the borrower to finish the construction projects and repay their loans to the Company. The downturn in the real estate construction market has been protracted, and although the Company has had some success in its restructuring efforts, it is difficult to conclude that we will be entirely successful in our efforts. Areas such as Bakersfield California have been slow to recover. During the three months ended March 31, 2011, no restructured loans were charged off or transferred to OREO. The Company may be required to make additional concessions in the future including lower lot release prices to allow borrowers to complete and sell construction units at lower prices currently reflected in the real estate market.

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Credit Quality Indicators

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

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

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

Facility Rating:

The facility rating is determined by the analysis of positive and negative factors that may indicate that the quality of a particular loan or credit arrangement requires that it be rated differently from the risk rating assigned to the borrower. The Company is conservative in assessing 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 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. In arriving at 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

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Extraordinary risks

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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 is to apply:

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 strong earnings history or net worth. These may be secured by deposit accounts or high-grade investment securities.

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

Grades 4 and 5 – These include "pass" grade loans to borrowers of acceptable credit quality and risk. The borrower's balance sheet and financial ratios may be below industry averages, but above the lowest industry quartile. Leverage is above and liquidity is below industry averages. Inadequacies evident in financial performance and/or management sufficiency are offset by readily available features of support, such as adequate collateral, or good guarantors having the liquid assets and/or cash flow capacity to repay the debt. The borrower may have recognized a loss over three or four years ago, 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 complying 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, for loans given a grade 5, the borrower's financial condition, cash flow or operations evidence more than average risk and short term weaknesses that 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 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 have all the same characteristics that the Substandard 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 is not practical or desirable to defer writing off asset even though partial recovery may be achieved in the future.

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The following tables summarize the credit risk ratings for commercial, construction, and other non-consumer related loans for March 31, 2011 and December 31, 2010. The Company did not carry any loans graded as loss at March 31, 2011 or December 31, 2010.

March 31, 2011 (000's)	Commercial				Total
	and Lease Financing	Commercial RE	Construction	Agricultural	
Grades 1 and 2	\$ 840	\$ 1,106	\$ 0	\$ 0	\$ 1,946
Grade 3	4,230	6,623	927	0	11,780
Grades 4 and 5 – pass	130,948	113,452	34,053	34,481	312,934
Grade 6 – special mention	7,491	4,195	11,063	0	22,749
Grade 7 – substandard	18,571	5,719	18,687	1,797	44,774
Grade 8 – doubtful	0	0	0	0	0
Total	\$ 162,080	\$ 131,095	\$ 64,730	\$ 36,278	\$ 394,183

December 31, 2010 (000's)	Commercial				Total
	and Lease Financing	Commercial RE	Construction	Agricultural	
Grades 1 and 2	\$ 990	\$ 1,112	\$ 0	\$ 79	\$ 2,181
Grade 3	302	6,786	937	0	8,025
Grades 4 and 5 – pass	134,058	113,515	33,082	41,597	322,252
Grade 6 – special mention	7,770	4,419	10,737	1,525	24,451
Grade 7 – substandard	16,409	5,800	20,426	3,107	45,742
Grade 8 – doubtful	0	0	0	0	0
Total	\$ 159,529	\$ 131,632	\$ 65,182	\$ 46,308	\$ 402,651

The Company follows consistent underwriting standards outlined in its loan policy for consumer and other homogenous 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 homogenous loans for March 31, 2011 and December 31, 2010.

(000's)	March 31, 2011				December 31, 2010			
	Single family Residential	Home Improvement	Installment	Total	Single family Residential	Home Improvement	Installment	Total
Not graded	\$ 17,668	\$ 2,159	\$ 11,152	\$ 30,979	\$ 18,236	\$ 2,225	\$ 11,429	\$ 31,890
Pass	4,465	113	1,347	5,925	3,964	22	1,313	5,299
Special Mention	0	0	0	0	195	0	0	195
Substandard	1,546	18	173	1,737	1,369	138	149	1,656
Total	\$ 23,679	\$ 2,290	\$ 12,672	\$ 38,641	\$ 23,764	\$ 2,385	\$ 12,891	\$ 39,040

Allowance for Loan Losses

The allowance for credit losses represents management's estimate of the risk inherent in the loan portfolio based on the current economic conditions, collateral values and economic prospects of the borrowers. Significant changes in these estimates might be required in the event of a downturn in the economy and/or the real estate markets in the San Joaquin Valley, the greater Oakhurst and East Madera County area, and in Santa Clara County.

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An analysis of changes in the allowance for credit losses is as follows:

(In thousands)	Periods Ended		
	March 31, 2011	December 31, 2010	March 31, 2010
Balance, beginning of year	\$16,520	\$15,016	\$15,016
Provision charged to operations	890	12,475	1,631
Losses charged to allowance	(699)	(11,936)	(449)
Recoveries on loans previously charged off	34	965	6
Balance at end-of-period	\$16,745	\$16,520	\$16,204

The allowance for credit losses maintained at a level deemed appropriate by management to provide for known and inherent risks in existing loans and commitments to extend credit. The adequacy of the allowance for credit losses is based upon management's continuing assessment of various factors affecting the collectability of loans and commitments to extend credit; including current economic conditions, past credit experience, collateral, and concentrations of credit.

The allowance for loan losses includes an asset-specific component, as well as a general or formula-based component. The Company segments the loan and lease portfolio into eleven (11) segments, primarily by loan class and risk type, that have homogeneity and commonality of purpose and terms for analysis under the formula-based component of the allowance. Loans that are determined to be impaired under current accounting guidelines are not subject to the formula-based reserve analysis, and are evaluated individually for specific impairment under the asset-specific component of the allowance.

Specific allowances are established based on management's periodic evaluation of loss exposure inherent in classified loans, impaired loans, and other loans in which management believes there is a probability that a loss has been incurred in excess of the amount determined by the application of the formula allowance. For impaired loans, specific allowances are determined based on either the collateralized value of the underlying properties, the net present value of the anticipated cash flows, or the market value of the underlying assets.

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

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

The Company utilizes a migration model to determine the formula allowance loss factors for problem-graded loans (substandard, doubtful, and loss), special mention loans, and pass graded loans. The migration analysis incorporates loan losses over the past twelve quarters (three years) and loss factors are adjusted to recognize and quantify the loss exposure from changes in market conditions and trends in the Company's loan portfolio. For purposes of this analysis, loans are grouped by internal risk classifications, which are "pass", "special mention", "substandard", "doubtful", and "loss."

Certain loans are homogenous in nature and are therefore pooled by risk grade. These homogenous loans include consumer installment and home equity loans.

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

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

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

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

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

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

Home improvement and home equity loans – Because of their junior lien position, these loans are inherently considered to have a 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 loans – This segment in a normal economy is considered to have a higher risk profile due to construction and market value issues in conjunction with normal credit risks. In the current distressed residential real estate markets the risk has increased.

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

Consumer loans (including three segments: consumer loans, overdrafts, and overdraft protection lines) – This segment is higher risk because many of the loans are unsecured.

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

The following summarizes the activity in the allowance for credit losses by loan category for the three months ended March 31, 2011.

	Commercial and Industrial	Real Estate Mortgage	RE Construction Development	Agricultural	Installment & Other	Lease Financing	Unallocated
March 31, 2011 (in 000's)							